

The Effects of Offshoring on Jurors' Evaluations of Auditor Liability and Plaintiff's Awards

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Abstract

The Big 4 public accounting firms recently began pilot testing the offshoring of certain auditing procedures of U.S. registrants to the firms' affiliated offshore entities (AOEs). We take a proactive approach to this recent development by investigating a potential unintended effect of offshoring audit procedures -- larger damage awards in plaintiffs' litigation against auditors -- based on the possibility that jurors may perceive work performed by offshore entities as lacking sufficient quality to avoid liability in the event of an audit failure. We find that while the location and affiliation of the staff auditor performing an auditing task indirectly related to an audit failure do not directly influence potential jurors' assessments of liability and damage awards, assessments and awards may be influenced by individuals' perceptions of the appropriateness of the judgment required by the task and the level of supervision. Our results also indicate that jurors are unable to discern the level of judgment associated with individual auditing tasks, suggesting that if auditing firms want to receive the benefits of offshoring without increasing the potential for damage awards, that jurors must be educated on the nature of auditing tasks.

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I. Introduction

Auditing firms have been assessed hundreds of millions of dollars in damages when audit failures occur and they are found by judges or jurors to have not performed their audit in a manner that represents a level of quality sufficient to avoid liability. For example, a jury recently determined the accounting firm BDO Seidman was negligent in its audit of Banco Espirito and awarded the plaintiffs \$170 million in compensatory damages, together with an additional \$352 million in punitive damages (\$522 million in total) – an amount thought to be the largest judgment ever against an accounting firm (Osterland 2007).¹ BDO Seidman's annual audit fee for the Banco Espirito engagement was \$250,000 and the audit firm's net worth was reported as \$41 million (Osterland 2007). The determination of audit quality is subjective and, in the case of jurors, may vary based upon their familiarity with professional auditing standards and their individual biases, among other factors.

The Big 4 public accounting firms recently began pilot testing the offshoring of certain auditing procedures on large U.S.-based audit engagements to the firms' affiliated offshore entities (AOEs). Evidence of the expansion of the offshoring concept is provided in a video produced by Deloitte which can be viewed at: <http://www.youtube.com/watch?v=Vkm6OlBHCic> (accessed November 21, 2008). The audit procedures currently offshored are reported by the firms as requiring little or no auditor judgment. Offshoring is the process of using unaffiliated foreign companies or AOEs to manufacture goods or perform services (e.g. customer procurement and service

¹ BDO Seidman is currently in the process of appealing the judgment. The Third District Court of Appeal for the state of Florida remanded the case back to the trial court in an opinion issued in early 2008.

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activities, human resource processes, software programming, and document retention and storage).

Offshoring to AOE's differs from the referral of audit work to overseas affiliates. Auditing firms frequently refer audit work for U.S. registrants who have foreign subsidiaries to affiliates (or other audit firms). Generally, the books and records of these foreign subsidiaries reside outside of the U.S. in a foreign country. Similarly, auditing firms frequently refer audit work to their other domestic practice offices when subsidiaries are located in different geographic regions within the U.S. To our knowledge, and based on discussions with certain assurance partners with the Big 4, the current pilot testing is the first time that audit procedures on the *domestic* books and records of U.S. registrants has been offshored to *foreign* AOE's.

Offshoring companies are frequently located in developing countries such as India, China, Pakistan, the Philippines, and Vietnam. The advantages of offshoring generally pertain to the wage and benefit gap between a company's U.S.-based employees and the offshore entities' employees. Although several large public accounting firms have previously used AOE's to perform certain audit procedures for their U.S. registrants' *foreign* operations, and have used AOE's to perform certain *non-audit* procedures such as the preparation of client tax returns (Houlder 2007), the current pilot tests are notably different in that the AOE is performing *audit* procedures with respect to U.S. clients' *domestic* operations.

While there are advantages to offshoring, a number of large corporations have been criticized for moving domestic work to foreign locations, notably in the manufacturing and service sector arenas. For example, in 2003 Dell moved customer

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service calls from its business customers back to the U.S. after receiving a large number of complaints about the quality of service at its Indian call center (Light 2005).

We take a proactive approach to this recent development in the auditing profession by investigating a potential unintended effect of offshoring audit procedures -- larger damage awards in plaintiffs' litigation against auditors -- based on the possibility that jurors may perceive work performed by offshore entities as lacking sufficient quality to avoid liability in the event of an audit failure. Specifically, we examine whether potential jurors' assessments of liability and damages attributed to auditors vary based on whether auditing procedures, indirectly related to an audit failure, have been offshored. We also investigate several related research questions (RQs) regarding the influence of the nature of the task leading to an audit failure, and jurors' perceptions of the amount of judgment required by the task, on their assessments of auditor liability and damages. The answers to these questions are important to practitioners, market participants and regulators given the magnitude of damages typically awarded in litigation against auditors, and are timely given the infancy of offshoring certain auditing procedures to AOE's.

We address the study's research questions using an experimental questionnaire administered to participants qualified to be called for jury duty. By holding the consequences of the audit failure constant, we focus participants on the location of the performer of the audit task, and the nature of the audit task. We find that while the location and affiliation of the staff auditor performing the task indirectly related to an audit failure do not directly influence prospective jurors' assessments of liability and damage awards, assessments and awards may be influenced by individuals' perceptions

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of the appropriateness of the judgment required by the task and the level of supervision, suggesting that if auditing firms want to receive the benefits of offshoring without increasing the potential for damage awards, that jurors must be educated on the nature of auditing tasks.

Our findings contribute to research on differences between auditors' and financial statement users' views of audit quality (the expectations gap) based on Jennings et al.'s (1991) assertion that the beliefs of jurors can be expected to represent the attitudes and perceptions of financial statement users and the general public, and under the assumption that auditors would only choose to offshore those processes where they believe that audit quality has not been diminished and audit risk has not been heightened.

This paper proceeds as follows. In Section II, we provide background relevant to the development of our research questions. Section III describes our experimental methodology, the results are presented in Section IV, and conclusions and implications are presented in Section V.

II. Background and Development of Research Questions

Audit failure is generally defined as an auditor issuing an unqualified opinion on a company's financial statements, and those financial statements are later determined to have been materially misstated. The auditor may be deemed negligent in connection with an audit failure if he or she (1) fails to follow generally accepted auditing standards, now including standards adopted by the Public Company Accounting Oversight Board, or (2) when the standard of care exercised by the auditor is judged to be below a certain minimum level of care (Causey and Causey 1991).

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Kadous (2000) provides evidence suggesting that the standard of care requirement is a function of the magnitude of the consequences of the audit failure, not the *ex ante* assessment of the appropriateness of the auditing procedures performed. In other words, in spite of the level of care demonstrated by an auditor to ensure a quality audit, auditors may still be assessed damages when audit failures occur. Lowe et al. (2002) report evidence consistent with Kadous (2000) that jurors may differently weight factors in their assessments of responsibility versus findings of damage in the rendering of negligence verdicts. Specifically, Lowe et al. (2002) found jurors suppressed factors such as an audit firm's ability to fund damages when assessing responsibility but did allow such factors to influence damage awards. Clearly 'deep pockets' and other issues are factors audit firms have grappled with over the years as expectations by financial statement users *ex ante* are often in contrast with jurors' rendering of negligence verdicts in an *ex post* setting.

The likelihood of an audit failure is represented by the audit risk model which suggests that, in determining the type, timing and extent of auditing procedures to be performed (detection risk), auditors must first make an assessment of a client's inherent risk (e.g. complexity, types of transactions, industry, management characteristics) and control risk (e.g. management control environment, internal control quality). To the extent that either inherent risk or control risk is assessed too low, or the acceptable level of detection risk is set too high, the risk of audit failure increases.

In addition to managing audit risk, auditors must also manage audit engagement profitability. Audit firms must continuously work to increase both the efficiency and effectiveness of their audits in order to survive and thrive in the competitive audit market (Lowe et al. 2002). Detection risk is established at a level which considers both the

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effectiveness and efficiency of the audit procedures to be undertaken. Different strategies may be undertaken to hold detection risk constant while improving audit efficiency. For example, technology may reduce the auditor's time required to perform routine tasks like testing the clerical accuracy of client-prepared schedules or computer-generated reports. Similarly, standardized forms streamline data gathering and shorten the review process.

By using AOE's to perform certain auditing tasks, auditing firms presumably intend to maintain an appropriate level of detection risk on individual audits while simultaneously improving audit efficiency. A partner with one of the international accounting firms currently pilot testing the offshoring of audit procedures commented that the fully-loaded cost of domestic staff is approximately four times that of the firm's Indian staff at its AOE.² A different partner emphasized that the favorable wage gap was not influenced by a lack of credentialing as the foreign staff are degreed accountants at the staff level and chartered accountants (or eligible to become chartered accountants) at the supervisory level.

Auditing tasks are assigned to audit engagement team members based on the perceived level of skill and experience required to complete the auditing task. More complex tasks and tasks requiring greater levels of judgment are generally assigned to more experienced personnel. For example, it is unlikely that the realization of goodwill or going-concern evaluations would be assigned to an inexperienced audit staff. In the context of our study, we attempt to isolate jurors' perceived differences, if any, when tasks are assigned to a firm's personnel by selecting auditing tasks that could reasonably

² KPMG Faculty Symposium, June 28-29, 2007.

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be performed by staff-level auditors, regardless of whether they are employed directly by the auditing firm (domestically or through an AOE), or by an unaffiliated offshore entity.

The location of the performing auditor may or may not influence prospective jurors' views on the attribution of liability and damage awards. It is likely that there exists variation in potential jurors' perspectives and experiences about offshoring. It is also likely that potential jurors will attend to differing aspects of information presented in a lawsuit against an auditing firm; and these differences may occur in a random fashion. We are unaware of any studies that specifically examine the relationship between the auditor's location (domestic versus foreign) and association with the audit firm (affiliated versus unaffiliated) in the performance of auditing tasks and the rendering of negligence verdicts and damages. Accordingly, our first RQs investigate whether potential jurors' negligence verdicts and recommended plaintiff awards vary based on the location of the audit task performer and the firm's degree of affiliation with the offshore entity.

Formally stated,

RQ1a: Are jurors' negligence verdicts and recommended plaintiff awards influenced by the audit task performers' location (domestic versus foreign)?

RQ1b: Are jurors' negligence verdicts and recommended plaintiff awards influenced by the audit task performers' affiliation with the audit firm (AOE versus unaffiliated)?

Auditing tasks can be classified as administrative or non-administrative. For example, recording the amount of time incurred by engagement personnel, and the organization, filing, and storage of audit working papers are administrative tasks. Sending accounts receivable confirmations, vouching property and equipment additions,

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and testing the adequacy of the allowance for doubtful accounts are non-administrative tasks.

Non-administrative auditing tasks can be further divided into those that require substantial judgment, and those requiring little to no judgment. However, the dividing line between judgmental and non-judgmental classifications may not be as clear as that for separating administrative and non-administrative tasks. For example, dependent upon an individual's familiarity with accounting or auditing procedures, it may be clear that the *selection* of customers to receive accounts receivable confirmations is a judgmental auditing task, while at first glance the actual *sending* and *receiving* of accounts receivable confirmations may be viewed as a non-judgmental auditing process. But suppose a customer confirms a balance as of a date different than that requested by the confirmation. The task of receiving accounts receivable confirmations then includes a judgment of whether or not the confirmation should be viewed as being received. Even a task such as vouching property and equipment additions may be perceived as requiring some level of judgment (e.g. the selection of specific items to vouch).

Accordingly, the assessment of whether non-administrative auditing tasks are judgmental or non-judgmental is a continuum and it is therefore probable that individuals – including prospective jurors – will have differing opinions on the extent of judgment required by various auditing tasks. Further, it is likely that the relevance of the judgment required by an auditing task on assessments of liability and recommended damage awards will vary among jurors. It is possible that when audit tasks are perceived to require more (less) judgment, potential jurors consider that auditors have less (more) control over negative outcomes, such as audit failures, and therefore attribute less (more) liability and

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damages to the auditor. It is also possible that when audit tasks are perceived to require more (less) judgment, potential jurors consider that the possibility of fraud increases (decreases). Given the gap in expectations regarding the auditor's responsibilities to detect fraud (Frank et al. 2001), it may be that assessments of liability and damage awards are positively related to prospective jurors' perceptions of judgment required by an audit task. As with location of the performing auditor, it is also likely that potential jurors will attend to differing aspects of information presented in a lawsuit; and these differences may occur in a random fashion.

Although some research uses judgmental auditing tasks in studies of the expectation gap between auditors and users of financial statements (e.g. Kinney and Nelson 1996), we are unaware of any study that has specifically examined the relationship between the nature of auditing procedures (*perceived* level of judgment required to complete the task) and differences in the expectation gap of financial statement users. Therefore, our second RQ investigates whether there is a relationship between jurors' perceptions of the degree of judgment inherent in the performance of certain auditing procedures and the determination of negligence and the amount of recommended plaintiff's awards. Formally stated,

RQ2: Are jurors' negligence verdicts and recommended plaintiff awards influenced by the perceived level of judgment required by the auditing task?

If prospective jurors' negligence verdicts and recommended plaintiffs' awards are influenced by the level of perceived judgment required to complete the auditing procedure, an important secondary issue arises with respect to the ability of participants to *distinguish* the relative level of judgment required in performing an audit task. To the

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extent participants are able to distinguish between tasks requiring varying levels of auditor judgment, the firms pilot testing the offshoring concept are supported in their initial decision to limit the offshored tasks to those requiring little to no judgment. However, if participants are unable to distinguish between audit tasks requiring differing levels of judgment, audit firms may be faced with an economic incentive to offshore an increasing number of audit tasks, including increasingly judgmental areas, in an effort to maximize economic reward in order to offset the risk inherent with a persistent expectation gap.

We are unaware of any studies that specifically address the ability of prospective jurors to distinguish the degree of judgment required by an audit task. Thus, our third RQ addresses the ability of participants to distinguish the degree of judgment required in completing various audit tasks, *vis-à-vis* experts' consensus of the relative level of judgment required for each task. Formally stated,

RQ3: Are jurors able to distinguish the degree of judgment required to complete an audit task for procedures that practicing auditors confirm require differing degrees of judgment?

Finally, our fourth RQ investigates the possibility that the location of the performer of the audit task and the degree of judgment required by the audit task interact when jurors assess auditor liability and recommend plaintiff damages in securities litigation. As an example, it may be that auditor liability and/or damage awards are only positively related when an audit task requires a significant amount of judgment, *and* when the task is offshored to a foreign-based entity. Formally stated,

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RQ4: Are jurors' negligence verdicts and recommended plaintiff awards influenced by the location of the audit task performer, contingent upon the perceived level of judgment required by the auditing task?

It is likely that prospective jurors have varying experiences, particularly related to accounting and auditing topics, which may contribute to outcomes investigated by each of the study's RQs. Accordingly, in addition to our analyses of the main effects attributed to the above RQs, we also consider the potential effects of individuals' accounting and auditing experiences and perceptions on the study's results.

III. Methodology

To address the study's research questions, a between-subjects experiment is conducted. A copy of the experimental instrument may be found in the Appendix.

Participants are undergraduate business and non-business students from a state university located in the southeastern U.S. To qualify as a participant in the study, students must have met the requirements of their state to be called upon as a juror (i.e., generally at least 18 years of age, registered to vote, and not a convicted felon).

Undergraduate university students are qualified participants as (1) they actually have been jurors or are potential jurors; (2) prior research has investigated the relationship between students' views and jurors' verdicts in product liability and medical malpractice litigation and found no differences (Bornstein and Rajki 1994; Zickafoose and Bornstein 1999; Bornstein 1999); (3) in a recent accounting study, Kadous (2001) compares the views of mock jurors from different pools of potential jurors to students' views and finds no differences; and (4) although some studies recruit participants from

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actual jury pools (e.g. Lowe et al. 2002), there is no assurance that the participants were actually seated on a jury panel or served as a juror.

In addressing RQ1a and 1b, three types of audit task performers are operationalized: (1) audit staff members under the *direct* supervision of the domestic audit team (Domestic); (2) audit staff employees of an AOE under the *indirect* supervision of the domestic audit team (Foreign AOE); and (3) audit staff employees of an unaffiliated foreign entity under the *indirect* supervision of the domestic audit team (Unaffiliated Foreign Entity). A post-experimental manipulation check is included to determine whether participants' attended to the location of the performer of the audit task.

In addressing RQ2, three non-administrative auditing tasks (confirmed by practicing auditors as requiring varying levels of auditor judgment) are operationalized in the experiment: (1) mailing and receiving cash confirmations (Confirms), (2) tracing property and equipment purchases to vendor invoices (PP&E), and (3) analyzing the adequacy of the allowance for doubtful accounts (Allowance).³ In support of the realism of the experiment, each of these audit tasks can be related to a recent actual audit failure. In the Parmalat case, auditors reportedly received fictitious cash confirmations. In the WorldCom case, property and equipment additions included expenditures for what was subsequently judged as being properly classified as repairs and maintenance expense. In the HealthSouth case, accounts receivable allowances reportedly were understated. None of these audit failures is referred to in the experiment's background materials; however,

³ As presented in the Appendix, the audit task is described, and participants' perspectives on the amount of judgment required by the task are solicited, in the same part of the experimental instrument. In other words, participants are able to refer back to the description of the task, if necessary. Accordingly, no post-experimental manipulation check for participants' attention to the audit task was required.

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post-experimental data is collected to determine if participant responses are influenced by their knowledge of audit failures in general, and their knowledge of these specific audit failures in particular.

In addressing RQ3, participants' assessments of the level of judgment required to complete the assigned non-administrative audit task are compared to the mean assessments for the other tasks to determine if our potential jurors are able to distinguish the relative level of judgment required. We also obtain consensus means from practicing auditors to validate the results and interpretations.

In addition to the post-experimental data on jurors' knowledge of accounting failures discussed above, participants are also requested to provide post-experimental data intended to measure their knowledge of accounting and auditing, their familiarity with the legal system, and their general attitude toward the auditing profession. These factors have been previously found to influence auditor liability (Jennings et al. 1991).

IV. Results

Respondents were recruited from introductory business courses at the participating university. A total of 349 research instruments were administered. After elimination of instruments with failed manipulation check questions ($n = 10$), 339 were usable in the study's analyses. Table 1 tabulates demographic data for the participants.

[Insert Table 1 about here]

Demographic Data

The participants are relatively young with 37.4 percent self-reporting an age of less than 20 and 60.6 percent within the 20-29 age bracket (Panel A of Table 1). Sixty percent of the participants are male (Panel B of Table 1) and only 11.8 percent reported

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majoring in accounting (Panel C of Table 1). The participants have limited work experience in accounting and auditing (Panel D of Table 1), with 79.4 percent and 97.1 percent, respectively, reporting no prior experience in these professions.

Panel E of Table 1 provides the participants' relative degree of familiarity with auditing procedures, audit failures, Parmalat, WorldCom, and HealthSouth (each measured on a three-point scale as: 1 = Not at all familiar, 2 = Somewhat familiar, and 3 = Very familiar). Participants reported minimal familiarity with auditing procedures and audit failures with mean values of 1.41 and 1.31, respectively. Likewise, participants reported minimal familiarity with the companies used to support the realism of the experimental materials. The mean levels of familiarity with Parmalat, WorldCom, and HealthSouth were 1.07, 1.56, and 1.25, respectively. The lack of strong familiarity with the above measures is important in the experimental manipulations as participants (prospective jurors) exhibiting a high degree of familiarity would likely be excluded from jury service due to the pre-emptive juror strikes afforded legal counsel in the *voir dire* process.

Panel F of Table 1 shows that participants, on average, have a near neutral perception of the auditing profession with a mean value of 1.85 (measured on a three-point scale as 1 = Very respected, 2 = Neutral, and 3 = Not very respected).

Participants also have little prior experience with the legal system (Panel G of Table 1), with only 15 percent reporting they had previously been summoned to jury duty, and approximately five percent indicating they had prior experience with jury service, being a plaintiff in a lawsuit, and being a defendant in a lawsuit.

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Administration of Experimental Instrument

The experimental instrument was administered in 13 separate sessions (averaging 26 participants per session) such that the proctor could carefully monitor the participants and encourage them to pay close attention to the materials. Each session was conducted in a classroom setting with volunteers from the introductory business courses. The students did not receive extra credit or compensation for their participation. Three students opted not to participate in the experiment. Table 2 presents descriptive statistics of the dependent variables used in the study's analyses.⁴

[Insert Table 2 about here]

Panel A of Table 2 provides participants' assessed liability of the auditor (measured on a nine-point Likert scale where 1 = No Liability and 9 = Complete Liability). The assessed degree of liability was 5.81, 5.84, and 5.75 for the Confirms, PP&E, and Allowance audit tasks, respectively; and was 5.72, 5.91, and 5.77 for the Domestic, AOE, and Unaffiliated Foreign Entity locations, respectively.

Panel B of Table 2 provides participants' recommended monetary damages against the auditor (measured on a nine-point Likert scale where 1 = Zero and 9 = More than \$1 Billion). The assessed monetary damages were 5.97, 5.67, and 6.14 for the Confirms, PP&E, and Allowance audit tasks, respectively; and were 5.91, 5.88, and 5.99 for the Domestic, AOE, and Unaffiliated Foreign Entity locations, respectively.

Panels C and D of Table 2 provide participants' perceptions of the appropriateness of the location and supervision of the staff assigned to the auditing task

⁴ As some participants did not complete all parts of the study's experimental materials, the number of responses summarized in Table 2 ranges between 337 and 339.

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(measured on a nine-point Likert scale where 1 = Inappropriate and 9 = Appropriate).

Participants on average reported beliefs about the appropriateness of the location of the staff as 4.98, 4.28, and 4.63 for the Domestic, AOE, and Unaffiliated Foreign Entity locations, respectively; and beliefs about the appropriateness of supervision as 4.63, 4.49, and 4.65 for the Domestic, AOE, and Unaffiliated Foreign Entity locations, respectively.

Panel E of Table 2 provides participants' judgment perceptions for sending and receiving confirmations of cash deposited at independent banking institutions (Confirms), tracing a sample of additions to property and equipment to vendor invoices (PP&E), and assessing the adequacy of the allowance for doubtful accounts receivable (Allowance). The level of judgment required (measured on a nine-point Likert scale where 1 = No Judgment and 9 = Significant Judgment) was assessed by the participants as 4.83, 4.87, and 5.25 for the Confirms, PP&E, and Allowance audit tasks, respectively.

Influence of Audit Task Performer's Location and Affiliation on Negligence Verdicts and Recommended Plaintiff Awards

RQ1a and RQ1b investigate whether potential jurors' negligence verdicts and recommended plaintiff awards are influenced by the audit task performer's location (domestic versus foreign) and affiliation with the audit firm (affiliated versus unaffiliated). To test RQ1a and RQ1b, we use analysis of variance (ANOVA) to measure the effects of audit performers' location and affiliation on the liability of the auditor (Liability) and monetary damages awarded to plaintiffs (Awards). Table 3 provides the ANOVA results.

[Insert Table 3 about here]

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For RQ1a, participants were coded as domestic if the staff accountant was located in Detroit and coded as foreign if the staff was located at the firm's AOE in India or at an unaffiliated foreign entity in India. Panel A of Table 3 indicates that the location of the staff accountant had no influence on the auditor's liability to the plaintiff ($p = .62$) or on the monetary damages awarded to the plaintiff and to be paid by the auditor ($p = .92$).

For RQ1b, participants were coded as affiliated if the staff accountant was located in Detroit or at the firm's AOE and coded as unaffiliated if located at the unaffiliated Indian entity. Panel B of Table 3 indicates that the affiliation (or lack of affiliation) had no influence on the auditor's liability ($p = .85$) or on the awarded damages ($p = .70$).

To further investigate any potential influences of audit staff location or affiliation on litigation outcomes, we perform supplemental one-way, between-groups ANOVA with participants coded into one of three groupings: (i) domestic staff, (ii) foreign staff at the firm's AOE, and (iii) foreign staff at an unaffiliated entity. Panel C of Table 3 provides the results that again indicate that location and affiliation do not influence the Liability ($p = .77$) or Awards ($p = .92$) variables.

Collectively, these results provide initial evidence suggesting that audit firms may benefit from the offshoring of certain auditing tasks on domestic clients. The potential auditor liability and damage awards recommendations in litigation against the auditor do not appear to be influenced by the location or affiliation of the performing staff (audit *effectiveness*), and the *efficiency* of the audit engagement is enhanced due to the favorable wage gap of practitioners at the foreign location versus their domestic counterparts. It may be that participants do not perceive a connection between the performing auditor's location, the audit failure, and Liability and Awards. It may also be that the participants

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have unique characteristics or experiences which contribute to the study's findings. We next supplementally address these possibilities.

Supplemental Analyses -

Participants were asked to respond to statements regarding their years of accounting and auditing experience. Their responses are presented in Panel D of Table 1. We next examine the potential influence of these external factors on participants' assessments of Liability and Awards. ANOVA results presented in Panel D of Table 3 suggest that accounting and auditing experience are insignificant determinants of Liability; and that the influence of potential jurors' accounting experience, but not auditing experience, is moderately significant ($p = .06$) in the determination of Awards.

On average our participants are younger than the general population. It is possible that given their age demographic, our participants are more comfortable with offshoring than the overall general population. Our test of the influence of age on participants' assessments of Liability and Awards is presented in Panel E of Table 3. ANOVA results suggest that the effect of the age is not a significant determinant of Liability and Awards ($p = .41$ and $p = .71$, respectively).

Participants were also asked to report their opinions on two questions related to the location/affiliation variables: whether they believed that the location of the staff and the level of supervision were appropriate. Their responses are summarized in Panels C and D of Table 2. Correlation analysis (untabulated) suggest that the stated location and affiliation of the staff assigned to complete the specified audit task, and participants' reported perceptions of the appropriateness of the staff location and supervision, are not highly correlated at traditional levels of significance and range from $-.02$ to $.12$.

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We consider whether participants' perceptions of the appropriateness of staff location and level of supervision influence their assessments of Liability and Awards. In other words, it is possible that an audit staff's location/affiliation *per se* is not influential, but a juror's perception of the appropriateness of the staff member's location and level of supervision may influence their assessment of Liability and Awards. Results presented in Panels F and G of Table 3 suggest that in certain circumstances this may be the case. While participants' views on the appropriateness of the staff location do not appear to influence the assessment of Liability and Awards ($p = .60$ and $p = .17$); participants' perceptions of the appropriateness of the level of supervision do appear to influence their assessments of Awards ($p = .01$).

Influence of Audit Judgment on Negligence Verdicts and Plaintiff Awards

To test RQ2, we again use ANOVA to measure the effects of participants' perceived level of judgment required for the specific audit tasks on their assessments of Liability and Awards. Table 4 provides the results.

[Insert Table 4 about here]

The ANOVA results reveal that the perceived level of audit task judgment significantly influences both Liability ($F = 5.35$, $p = .02$) and Awards ($F = 5.06$, $p = .02$). Our potential jurors are increasingly likely to find against the auditor in an audit failure as the perceived level of judgment required to complete the audit task contributing to the audit failure increases. This finding lends initial credence to the decision of firms piloting the concept of offshoring certain audit procedures to limit the tasks to those requiring little or no judgment. However, this inference may be negated if potential

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jurors are unable to distinguish the levels of judgment required for audit tasks that practitioners agree require differing levels of judgment.

Participants' Ability to Distinguish Levels of Judgment Required to Complete Tasks

RQ3 investigates whether participants are able to distinguish the level of judgment required to complete differing audit tasks. Practicing auditors agree that the Confirms, PP&E, and Allowance audit tasks, respectively, require increasing levels of auditor judgment.⁵ Panel E of Table 2 shows that participants assessed the required level of auditor judgment in a monotonically increasing fashion for the Confirms (4.83), PP&E (4.87), and Allowance (5.25) audit tasks. In order to test whether the participants' judgment assessments are significantly different, we perform one-way, between-groups ANOVA for the participants assigned to each of the three audit tasks. Table 5 provides the results which suggest that potential jurors are unable ($p = .16$) to distinguish the differing levels of judgment required to complete the three audit tasks that practicing auditors concur require increasing levels of auditor judgment, consistent with the notion that the expectation gap persists.

[Insert Table 5 about here]

Post-hoc tests (not tabulated) reveal that there are no significant differences between any two of the three audit tasks ($p = .19$ for Confirms versus Allowance, $p = .26$ for PP&E versus Allowance, and $p = .99$ for Confirms versus PP&E).

⁵ In order to obtain an expert consensus on the level of judgment required for each of the three audit tasks, we polled 10 practicing auditors using the same nine-point Likert scale used by the participants. The consensus levels of required judgment by the practicing auditors were 2.40, 3.30, and 8.20 for the Confirms, PP&E, and Allowance tasks, respectively. The practicing auditors collectively represent six public accounting firms at the partner (eight) and manager (two) levels.

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It is possible that a participant's familiarity with auditing procedures may impact his or her ability to appropriately evaluate the amount of judgment associated with an audit task. We test for this possibility by performing an analysis of covariance (ANCOVA), including this variable as a covariate.⁶ Results presented in Panel B of Table 5 suggest this is the case. Participants' assessments of the judgment required by an audit task are influenced by their reported familiarity with auditing procedures ($p < .001$).⁷

Consistent with these analyses, assessing the influence of the individual audit task treatments (Confirms, PP&E, Allowance) on Liability and Awards (not tabulated) suggests that these variables are marginally significant predictors of Liability only when considered in light of participants' reported familiarity with auditing procedures ($p = .06$).

We extend our analyses and compare whether our participants' perceived level of judgment required for each audit task differs significantly from those of practicing auditors. Using the same nine-point Likert scale used by the participants, our panel of 10 practicing auditors reported consensus levels of required judgment of 2.40, 3.30, and 8.20 for the Confirms, PP&E, and Allowance tasks, respectively.

One-sample t-tests are conducted to compare the participants' mean level of judgment against the consensus mean of practicing auditors for each of the three audit tasks. The results are presented in Panel C of Table 5. For all three audit tasks, the

⁶ ANCOVA allows the inclusion of other independent variables to improve the precision of the experimental instrument. These covariates may eliminate other possible sources of variance in the dependent variable related to factors not controllable by the researcher (Lattin et al. 2003).

⁷ We also examine (untabulated) the influence of participants' reported experience in accounting and auditing. These covariates have no influence on participants' abilities to distinguish differences in judgment required by the specified audit tasks.

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participants' mean differed significantly ($p < .001$) from the expert group mean, with participants perceiving the Confirm and PP&E tasks to require substantially more judgment than the practicing auditors, and the Allowance task to require substantially less judgment than the experts' consensus. Even when participants report familiarity with auditing procedures, their assessments of the actual level of judgment associated with an audit task are significantly different than the assessments of auditors.

The Interaction between Location/Affiliation and Perceived Judgment Required by the Audit Task on Negligence Verdicts and Plaintiff Awards

RQ4 investigates whether participants' assessments of Liability and Award are influenced by the interaction of the location/affiliation of the audit task performer and their perceptions' of the judgment required when performing the audit task. To address the question, we first use a between groups ANOVA. Results are presented in Panels A (location) and B (affiliation) of Table 6 which suggest that the effects of the interaction of location and affiliation, and judgment are not significant.

[Insert Table 6 about here]

Based on our finding that participants' perceptions of the appropriateness of supervision are influential in the determination of Awards, we also investigate the impact of the interaction of the appropriateness of staff location and supervision variables with participants' perceptions of the judgment required to complete the audit task. Results are presented in Panels C (location) and D (supervision) of Table 6 which suggest that the interaction of participants' perceptions of staff location and supervision do not significantly impact Liability and Awards. Consistent with our prior findings, the inclusion of these interaction variables does not change the significance of participants'

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assessments of the judgment required to complete an audit task on Liability ($p = .04$), nor the influence of perceptions of the appropriateness of supervision on Awards ($p = .03$). Collectively, these results confirm our prior findings of the importance of jurors' perceptions of the judgment required by auditing tasks and the appropriateness of staff location and supervision.

We then consider the influence of participants' familiarity with auditing procedures – a variable found to be significant in our prior analyses - as a covariate in the analysis. Results (not tabulated) suggest that this covariate is insignificant and its consideration does not change the prior findings.

Robustness Tests (not tabulated)

In our attempts to reduce the likelihood of demand effects associated with the study's findings, it is possible that the location of the performing auditor was somehow obscured, contributing to our finding that location and/or affiliation do not matter. In other words, if the performing location was stated more predominantly in the instrument, our tests may have suggested that location and/or affiliation do influence Liability and Awards. To consider this possibility, we modified the instrument in several ways. First, in Part 2, the AOE treatment is revised to explicitly state that the audit procedures are “offshored to a foreign affiliate.” To reduce the likelihood of insufficient power, only two auditor location treatments were tested, Domestic and AOE. Second, in Part 3, we revised the information concerning the audit failure to explicitly state that the audit task assigned to the staff person in Detroit OR India may have contributed to investors' losses. Third, we added the following demographic question to Part 5:

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“Your perception of offshoring to foreign companies:
1 2 3 4 5
Very negative Somewhat negative Neutral Somewhat positive Very positive”

Again, to reduce the likelihood of insufficient power, only two audit tasks were tested - Confirms and Allowance.

The modified instrument was re-administered to 68 additional participants. The study's results presented in Panel C of Table 3 are substantially unchanged. Location of the staff person assigned to complete the audit task does not significantly influence Awards ($p > .10$), but moderately influences Liability ($p = .07$). In an attempt to better understand the moderate significance of location on Liability, we consider the influence of additional variables. First, we include participants' reported scores of the additional demographic question as a covariate in our analyses. Participants' scores range from one to five and average 2.46, suggesting a slightly negative view of foreign offshoring. We find that participants' perceptions of foreign offshoring do not influence participants' assignment of Liability and Awards.

Second, we find that consistent with the results presented in Panel F of Table 3, participants' assessments of Liability and Awards are not influenced by their perceptions of the appropriateness of the staff location ($p > .10$). Further, in part consistent with the results presented in Panel G of Table 3, participants' assessments of Liability and Awards are not influenced by their perceptions of the adequacy of supervision. Unlike the study's primary results, we do not find that perceptions of the adequacy of supervision significantly influence participants' assessment of Awards.

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Lastly, we analyze the impact of participants' reported perceptions of audit task judgment on assessments of Liability and Awards. We find that when participants' perceived levels of judgment required by the audit task are considered as an additional fixed factor, the influence of the staff auditor's location on Liability is no longer significant ($p = .87$), and the influence of perceived judgment required by the task on Liability is moderately significant ($p = .08$). Further, the interaction of perceived levels of judgment and the staff auditor's location significantly influence Awards ($p = .01$). Collectively, these results confirm the study's primary findings that prospective jurors' perceptions about the judgment required by an audit task are more important than the staff auditor's location in determining their assessments of Liability and Awards.

Jurors are often presented with expert witness testimony. If prosecuting and defense attorneys are concerned that the level of judgment required by an audit task indirectly related to an audit failure may influence jurors' assessments of liability and damage recommendations, it is likely that both sides would present (potentially conflicting) expert witness testimony. To consider the possibility that the results of our primary analyses might be altered by the opinions of experts in this regard, we modify Part 3 of the study's instrument to include the following additional fact:

"A panel of experts testifies that the auditing procedure related to the misstated account requires very little OR a significant amount of judgment."

The amount of judgment is dependent upon the task assigned (Confirms or Allowance). Again, to reduce the likelihood of insufficient power, only two audit tasks and two auditor location treatments (Domestic and AOE) were tested. The modified instrument was re-administered to 42 additional participants. Results remain unchanged. The

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location and affiliation of the staff assigned to the audit task (Panel C of Table 3) still has no influence on Liability and Awards ($p > .10$); and participants' perceptions of the appropriateness of the staff location (Panel F of Table 3) has no influence on Liability or Awards ($p > .10$), but perceptions of the appropriateness of supervision (Panel G of Table 3) continues to influence participants' recommendations of Awards ($p = .08$).

Additional Ad Hoc Analyses (not tabulated)

Jennings et al. (1991) report that individuals' general attitudes toward the auditing profession and their familiarity with the legal system influence their perception of auditor liability. Using data gathered and reported in Panels F (audit profession perceptions) and G (prior legal experience) of Table 1, we test whether these variables alter any of the study's main findings. ANCOVA analyses suggest that none of these variables change the lack of influence of staff location or affiliation, or the positive influence of both participants' perceptions of judgment required by the specified task and the appropriateness of supervision, on the assessment of Liability and Awards. In addition, results suggest that only Awards are marginally impacted by whether or not participants reported having served on a jury ($p = .08$). None of the other variables intended to proxy for familiarity with the legal system were significant covariates in the determination of Liability and Awards. Participants' opinions of the auditing profession were likewise insignificant determinants of Liability and Awards.

Data reported in Panel E of Table 1 regarding participants' familiarity with Parmalat, WorldCom, and HealthSouth are not considered in our supplemental tests given the lack of findings with respect to the specific audit tasks (Confirms, PP&E, and Allowance).

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V. Conclusions

In this study we proactively investigate whether, if audit firms choose to capitalize on the potential benefits associated with offshoring certain auditing tasks, they will inadvertently increase their exposure to future litigation. Currently, the notion of offshoring auditing tasks is in the pilot testing phase, and is currently being limited to those tasks requiring little or no judgment.

Our results suggest that prospective jurors report no difference in the attribution of liability or the amount of recommended awards based upon the location of the audit personnel assigned to the auditing task. These results are robust even when statements regarding the auditor's location are designed to create demand effects for the possibility that offshoring to a foreign entity may adversely contribute to an audit failure. Further, if jurors perceive that supervision levels in a traditional or offshored context are inappropriate, they may recommend higher damage awards.

Collectively, these findings provide initial evidence supporting the concept of offshoring or outsourcing certain auditing procedures to personnel located in foreign locations. Offshoring may be a viable possibility to address the issues of client fee fatigue and engagement profitability (efficiency), while not adversely impacting an audit's level of audit risk (effectiveness).

Our results also suggest that when audit failures occur, jurors are likely to assess liability and damages based on the level of judgment they perceive to be required by the related audit task. Jurors behave as if increasing levels of required auditor judgment increasingly contributes to the possibility of financial statement fraud, which they perceive auditors have the responsibility to detect. However, jurors are not likely to

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accurately assess the actual level of judgment required by an audit task. Further, findings of the influence of jurors' perceptions of the judgment associated with a given audit task on assessments of liability and damage awards are unchanged when considering the interaction effects of the location and affiliation of the staff assigned to the task. This suggests that if auditing firms want to receive the benefits of offshoring without increasing the potential for damage awards, that jurors must be educated on the nature of auditing tasks.

Not surprisingly, we find that potential jurors reporting familiarity with auditing procedures are better at assessing the judgment required to complete a specified audit task. However, we also find that individuals reporting familiarity with auditing procedures may be more likely to attribute liability to auditors in audit failures and therefore may not be ideal candidates for a jury pool (and more likely to be preemptively stricken by counsel) in litigation involving an audit failure.

Results of the study must be considered in light of their limitations, the most important of which is that our prospective jurors are not actual jurors. Although prior research suggests that students are reasonable surrogates for prospective jurors (e.g., Brandon and Mueller 2006), and very few studies use actual jurors due to difficulty accessing these individuals, differences in opinions and perceptions may occur. In addition, our participant potential jurors are young compared to the population taken as a whole, and compared to typical jury pools. Using actual jurors as participants, Lowe et al. (2002) report an average age of 40.6, compared to the mean age range of 20 to 29 of our participants. However, our tests suggest that age did not influence our participants' assessments of liability and the amount of damage awards.

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Our findings should also be considered in light of prior evidence that suggests individuals may attend to irrelevant information and therefore may make incorrect judgments about the potential for financial statement fraud (Hackenbrack 1992). In our experiment we attempted to limit the information provided to participants to only what we considered necessary to address the study's research questions. However, it is possible that participants attended to the information differently than we intended. We attempted to reduce the effects of this risk by having a large sample, conducting the experiment in multiple sessions (to limit the number of participants in each session), and by performing extensive robustness tests. In actual litigation against auditors, the amount of irrelevant information will vary; therefore it is possible that our results may not be replicated in an actual jury trial.

In addition to liability assessments and damage awards in securities lawsuits, there are other potential issues that should be considered by auditing firms prior to engaging in offshoring or outsourcing. These issues include: the potential for negative perception by clients, the need for process changes to ensure client confidentiality and audit quality, differences in data protection laws between the U.S. and the country of the firm's AOE, and potential impacts on staff retention and recruiting, each of which is more fully discussed by Daugherty and Dickins (2008).

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Auditor Liability and Plaintiff's Awards**

**TABLE 1
Demographic Data for Participants
(n = 339)**

Panel A - Age Groups:	<u>< 20</u> 37.4 %	<u>20-29</u> 60.6 %	<u>30-39</u> 1.8 %	<u>40-49</u> .3 %
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Panel B - Gender:	<u>Male</u> 60 %	<u>Female</u> 40 %
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Panel C - College Major:	<u>Accounting</u> 11.8 %	<u>Other Business</u> 52.4 %	<u>Other</u> 35.9 %
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Panel D - Prior Experience (years):	<u>None</u>	<u>1 – 2</u>	<u>3 – 5</u>	<u>6 – 10</u>	<u>>10</u>
Years of accounting experience	79.4 %	19.5 %	.6 %	.3 %	.3 %
Years of auditing experience	97.1 %	2.4 %	.3 %	.3 %	N/A

Panel E - Background Knowledge Level

(1 = Not at all familiar, 2 = Somewhat familiar, 3 = Very familiar)

<u>Degree of familiarity with:</u>	<u>Mean</u>	<u>Std. Dev.</u>
Auditing procedures	1.41	.54
Audit failures	1.31	.51
Parmalat	1.07	.26
WorldCom	1.56	.65
HealthSouth	1.25	.49

Panel F - Perception of the Auditing Profession	<u>Mean</u>	<u>Std. Dev.</u>
(1 = Very respected, 2 = Neutral, 3 = Not very respected)	1.85	.50

Panel G - Prior Legal Experience:

<u>Prior experience with:</u>	<u>Yes</u>	<u>No</u>
Summons to jury duty	15.0 %	85.0 %
Service on a jury	5.0 %	95.0 %
Plaintiff in a lawsuit	4.7 %	95.3 %
Defendant in a lawsuit	5.6 %	94.4 %

**The Effects of Offshoring on Jurors' Evaluations of
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**TABLE 2
Descriptive Statistics of Dependent Variables by Groupings**

Dependent Variables - Mean (Std Dev):

	(1 = No Liability, 9 = Complete Liability)		
Panel A: Liability of the Auditor:	Confirms	PP&E	Allowance
	<u>(n = 115)</u>	<u>(n = 110)</u>	<u>(n = 112)</u>
	5.81	5.84	5.75
	(2.15)	(1.98)	(2.04)
	Firm - Domestic	Firm - Foreign AOE	Unaffiliated Foreign Entity
	<u>(n = 114)</u>	<u>(n = 111)</u>	<u>(n = 112)</u>
	5.72	5.91	5.77
	(2.13)	(1.98)	(2.05)
	(1 = Zero, 9 = More than \$1 Billion)		
Panel B: Monetary Damages:	Confirms	PP&E	Allowance
	<u>(n = 115)</u>	<u>(n = 111)</u>	<u>(n = 112)</u>
	5.97	5.67	6.14
	(2.08)	(2.12)	(1.95)
	Firm - Domestic	Firm - Foreign AOE	Unaffiliated Foreign Entity
	<u>(n = 114)</u>	<u>(n = 111)</u>	<u>(n = 112)</u>
	5.91	5.88	5.99
	(2.07)	(1.97)	(2.14)
	(1 = Inappropriate, 9 = Appropriate)		
Panel C: Location of Staff:	Firm - Domestic	Firm - Foreign AOE	Unaffiliated Foreign Entity
	<u>(n = 114)</u>	<u>(n = 111)</u>	<u>(n = 112)</u>
	4.98	4.28	4.63
	(2.00)	(2.00)	(1.99)

(continues)

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

TABLE 2 (continued)

Dependent Variables - Mean (Std Dev):

	(1 = Inappropriate, 9 = Appropriate)		
Panel D: Level of Supervision	Firm - Domestic <u>(n = 114)</u>	Firm - Foreign AOE <u>(n = 111)</u>	Unaffiliated Foreign Entity <u>(n = 112)</u>
	4.63 (1.89)	4.49 (2.06)	4.65 (2.17)

	(1 = No Judgment, 9 = Significant Judgment)		
Panel E: Judgment Required for:	Confirms <u>(n = 115)</u>	PP&E <u>(n = 111)</u>	Allowance <u>(n = 113)</u>
	4.83 (1.77)	4.87 (1.95)	5.25 (1.63)

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Auditor Liability and Plaintiff's Awards**

TABLE 3

**Tests of RQ1a and RQ1b: Influence of Audit Task Performers' Location and Firm
Affiliation on Litigation Outcomes**

Dependent Variables: Auditor Liability, Recommended Plaintiff Awards

**Fixed Factors: RQ1a: Location (Domestic versus Foreign). RQ1b: Firm
Affiliation (Affiliated versus Unaffiliated)**

ANOVA Results for Audit Task Nature Variable (*LIABILITY, AWARDS*)

Panel A: RQ1a - Location

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	1.07	1	1.07	.25	.62
	Residual	1417.21	335	4.23		
	Total	1418.28	336			
<i>AWARDS</i>	Regression	.05	1	.05	.01	.92
	Residual	1422.25	336	4.23		
	Total	1422.30	337			

Panel B: RQ1b – Firm Affiliation

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	.16	1	.16	.04	.85
	Residual	1418.12	335	4.23		
	Total	1418.28	336			
<i>AWARDS</i>	Regression	.65	1	.65	.15	.70
	Residual	1421.65	336	4.23		
	Total	1422.30	337			

Panel C: Supplemental Analysis – Location and Affiliation

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Between Groups	2.20	2	1.10	.26	.77
	Within Groups	1416.08	334	4.24		
	Total	1418.28	337			
<i>AWARDS</i>	Between Groups	.69	2	.35	.08	.92
	Within Groups	1421.61	335	4.24		
	Total	1422.30	337			

(continues)

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

TABLE 3 (continued)

Panel D: Supplemental Analysis – Accounting and Auditing Experience

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	10.86	2	5.43	1.29	.28
	Acctg Experience	6.40	1	6.40	1.52	.22
	Audit Experience	3.17	1	3.17	.75	.39
	Residual	1404.18	333	4.22		
	Total	1415.04	335			
<i>AWARDS</i>	Regression	21.68	2	10.84	2.60	.08
	Acctg Experience	14.60	1	14.60	3.51	.06
	Audit Experience	4.70	1	4.70	1.13	.29
	Residual	1391.16	334	4.16		
	Total	1412.84	335			

Panel E: Supplemental Analysis –Age Covariate

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	2.92	1	2.92	.69	.41
	Residual	1415.36	335	4.22		
	Total	1418.28	336			
<i>AWARDS</i>	Regression	.57	1	.57	.14	.71
	Residual	1421.72	336	4.23		
	Total	1422.30	337			

(continues)

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

TABLE 3 (continued)

Panel F: Perceptions of the Appropriateness of Staff Location

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	27.25	8	3.41	.80	.60
	Residual	1374.31	325	4.23		
	Total	1401.56	333			
<i>AWARDS</i>	Regression	48.62	8	6.08	1.46	.17
	Residual	1356.21	326	4.16		
	Total	1404.82	334			

Panel G: Perceptions of the Appropriateness of Supervision

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	36.05	8	4.51	1.07	.38
	Residual	1365.51	325	4.20		
	Total	1401.56	333			
<i>AWARDS</i>	Regression	89.24	8	11.16	2.76	.01*
	Residual	1315.58	326	4.04		
	Total	1404.82	334			

* Significant at traditional levels.

LIABILITY = The liability, if any, of the auditor to plaintiffs (investors). Measured on a nine-point Likert scale with 1 labeled "No Liability" and 9 labeled "Complete Liability".
AWARDS = The monetary damages, if any, awarded to plaintiffs (investors), and to be paid by the auditor. Measured on a nine-point Likert scale with 1 labeled "Zero" and 9 labeled "More than \$1 Billion."

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TABLE 4
Tests of RQ2: Influence of Audit Task Judgment on Litigation Outcomes
Dependent Variables: Auditor Liability, Recommended Plaintiff Awards
Fixed Factor: Perceived Level of Judgment of the Auditing Procedure

ANOVA Results for Audit Task Nature Variable (*LIABILITY, AWARDS*)

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Regression	22.30	1	22.30	5.35	.02*
	Residual	1392.74	334	4.17		
	Total	1415.04	335			
<i>AWARDS</i>	Regression	21.15	1	21.15	5.06	.02*
	Residual	1400.28	334	4.18		
	Total	1421.43	335			

* Significant at the .05 level

LIABILITY = The liability, if any, of the auditor to plaintiffs (investors). Measured on a nine-point Likert scale with 1 labeled "No Liability" and 9 labeled "Complete Liability".

AWARDS = The monetary damages, if any, awarded to plaintiffs (investors), and to be paid by the auditor. Measured on a nine-point Likert scale with 1 labeled "Zero" and 9 labeled "More than \$1 Billion."

**The Effects of Offshoring on Jurors' Evaluations of
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TABLE 5

**Tests of RQ3: Ability of Participants to Distinguish the Level of Judgment
Required to Complete Audit Tasks**

**Dependent Variable: Perceived Level of Judgment of the Auditing Procedure
Fixed Factor: Participant Groups Assigned Confirms, PP&E, and Allowance Tasks**

Panel A: ANOVA Results for the Judgment Variable

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>JUDGMENT</i>	Between Groups	11.77	2	5.89	1.84	.16
	Within Groups	1073.16	336	3.19		
	Total	1084.93	338			

**Panel B: ANCOVA Results for the Judgment Variable – Familiarity with Auditing
Procedures Covariate**

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>JUDGMENT</i>	Between Groups	11.74	2	5.87	1.89	.15
	Auditing Procedures	33.71	1	33.71	10.86	.00 *
	Within Groups	1039.48	335	3.10		
	Total	1084.93	338			

Panel C: One-Sample t-Tests Comparing Participant Mean to Consensus Mean

	<u>Participant Mean</u>	<u>Consensus Mean</u>	<u>Difference</u>	<u>t-stat</u>	<u>p-value</u>
Confirms	4.83	2.40	2.43	14.74	.00 *
PP&E	4.87	3.30	1.57	8.52	.00 *
Allowance	5.25	8.20	(2.95)	-19.21	.00 *

* Significant at the .00 level.

JUDGMENT = Level of judgment required for the specific audit task described.

Measured on a nine-point Likert scale with 1 labeled “No Judgment” and 9 labeled “A Significant Amount of Judgment.”

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

TABLE 6
**Tests of RQ4: Influence of the Interaction of Audit Task Judgment and Staff
Location on Litigation Outcomes**
Dependent Variables: Auditor Liability, Recommended Plaintiff Awards

**Panel A: Impact of the Interaction of Perceived Level of Judgment of the Auditing
Task and Staff Location**

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Judgment	64.70	8	8.09	1.95	.05*
	Domestic	.01	1	.01	.00	.97
	Judg*Domestic	30.28	8	3.78	.91	.51
	Residual	1321.68	318	4.16		
	Total	1415.04	336			
<i>AWARDS</i>	Judgment	39.21	8	4.90	1.15	.33
	Domestic	6.22	1	6.22	1.47	.23
	Judg*Domestic	25.70	8	3.21	.76	.64
	Residual	1355.00	319	4.25		
	Total	1421.43	336			

**Panel B: Impact of the Interaction of Perceived Level of Judgment of the Auditing
Task and Staff Affiliation**

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Judgment	52.17	8	6.52	1.56	.13
	Affiliation	.16	1	.16	.04	.85
	Judg*Affiliation	30.28	8	3.78	.91	.51
	Residual	1326.96	318	4.17		
	Total	1415.04	336			
<i>AWARDS</i>	Judgment	35.84	8	4.48	1.06	.39
	Affiliation	.95	1	.95	.21	.63
	Judg*Affiliation	26.03	8	3.25	.77	.63
	Residual	1352.32	319	4.24		
	Total	1421.43				

(continues)

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

TABLE 6 (continued)

Panel C: Impact of the Interaction of Perceived Level of Judgment of the Auditing Task and Perception of Appropriateness of Staff Location

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Judgment	48.99	8	6.12	1.53	.15
	Staff	26.94	8	3.37	.84	.57
	Judg*Staff	224.26	46	4.87	1.22	.17
	Residual	1082.14	270	4.01		
	Total	1398.31	332			
<i>AWARDS</i>	Judgment	46.12	8	5.76	1.44	.18
	Staff	28.45	8	3.55	.89	.53
	Judg*Staff	230.19	46	5.00	1.25	.14
	Residual	1086.12	271	4.01		
	Total	1403.98	333			

Panel D: Impact of the Interaction of Perceived Level of Judgment of the Auditing Task and Perception of Appropriateness of Supervision

		<u>Sum of Squares</u>	<u>df</u>	<u>Mean Square</u>	<u>F</u>	<u>Sig.</u>
<i>LIABILITY</i>	Judgment	67.26	8	8.41	2.07	.04*
	Supervision	38.16	8	4.77	1.17	.31
	Judg*Supervision	215.92	51	4.23	1.04	.40
	Residual	1075.57	318	4.06		
	Total	1398.43	332			
<i>AWARDS</i>	Judgment	49.66	8	6.21	1.67	.13
	Supervision	68.54	8	8.57	2.16	.03*
	Judg*Supervision	225.60	51	4.42	1.12	.29
	Residual	1053.60	266	3.96		
	Total	1403.98	333			

* Significant at the .05 level

LIABILITY = The liability, if any, of the auditor to plaintiffs (investors). Measured on a nine-point Likert scale with 1 labeled "No Liability" and 9 labeled "Complete Liability".
AWARDS = The monetary damages, if any, awarded to plaintiffs (investors), and to be paid by the auditor. Measured on a nine-point Likert scale with 1 labeled "Zero" and 9 labeled "More than \$1 Billion."

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

**Appendix A
Experimental Instrument**

Part 1.

Company A is located in Detroit, Michigan. Company A presented its 2006 financial results in a set of financial statements which were audited by CPA. CPA's opinion on Company A's financial statements suggested that the financial statements were **not materially misstated**.

CPA is an international auditing firm. The CPA audit engagement team is located in Detroit, Michigan.

CPA's audit procedures were routine and included the following auditing procedure (one of the following treatments):

- sending and receiving confirmations of cash deposited at independent banking institutions, OR
- tracing a sample of additions to property and equipment to vendor invoices, OR
- assessing the adequacy of the allowance for doubtful accounts receivable.

Please respond to the following statement by circling the one response that **best describes your views**:

1. The nature of the specific auditing procedure described above requires:

	1	2	3	4	5	6	7	8	9
No Auditor Judgment									Significant Auditor Judgment

Please proceed to the next page, but do not refer back to prior information.

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

Part 2.

The audit procedure described on the prior page was performed by staff accountants with appropriate training who are (one of the following treatments):

- located in Detroit and directly supervised by the Detroit audit team.
- employed by CPA's controlled foreign entity located in India, directly supervised by employees in India, and indirectly supervised by the Detroit audit team.
- employed by an unaffiliated foreign entity located in India, directly supervised by unaffiliated employees in India, and indirectly supervised by the Detroit audit team.

All other auditing procedures were performed and supervised by members of the Detroit audit engagement team.

Please respond to the following statements.

2. The location of the staff accountant who performed the audit procedure was:

1	2	3	4	5	6	7	8	9
Inappropriate								Appropriate

3. The level of supervision by the Detroit audit engagement team of the staff accountant who performed the audit procedure was:

1	2	3	4	5	6	7	8	9
Inappropriate								Appropriate

Please proceed to the next page, but do not refer back to prior information.

The Effects of Offshoring on Jurors' Evaluations of Auditor Liability and Plaintiff's Awards

Part 3.

It was subsequently discovered that the 2006 financial statements materially overstated Company A's financial results. Investors lost approximately \$1 billion resulting from the decline in Company A's stock price on the date that management announced that the 2006 financial statements were in error. A \$1 billion lawsuit was filed alleging that management of Company A and CPA both failed to prevent or detect the misstatement of Company A's financial results. As a juror in the lawsuit you are presented with the following facts:

- Cash on deposit was materially overstated OR property and equipment were overvalued OR amounts due from customers (accounts receivable) were materially overvalued.
- Management of Company A represents that they complied with their responsibilities in preparing the financial statements.
- CPA represents that it complied with its professional responsibilities in auditing the financial statements.

Please respond to the following statements by circling the one response for each statement that best describes your views:

4. The liability, if any, of the auditor to plaintiffs (investors), should be:

1	2	3	4	5	6	7	8	9
No Liability								Complete Liability

5. The monetary damages, if any, awarded to plaintiffs (investors), and to be paid by the auditor, should be:

1	2	3	4	5	6	7	8	9
Zero								More than \$1 billion

Please proceed to the next page, but do not refer back to prior information.

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

Part 4.

Please respond to the following statements. **Please do not refer back to the case information.**

6. The staff person assigned to complete the audit procedure that was indirectly related to the error in the financial statements was located in (check one only):

Detroit, Michigan

India

Other

7. The location of the staff accountants who performed the audit procedure previously described was:

1	2	3	4	5	6	7	8	9	
Inappropriate								Appropriate	

7. The level of supervision by the Detroit audit engagement team of the staff accountants who performed the audit procedure previously described was:

1	2	3	4	5	6	7	8	9	
Inappropriate								Appropriate	

Please proceed to the next page, but do not refer back to prior information.

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

Part 5.

Please respond to the following statements by circling the one response for each statement that best describes you.

1. Your degree of familiarity with auditing procedures:

1	2	3
Not at all Familiar	Somewhat Familiar	Very Familiar

2. Your degree of familiarity with audit failures:

1	2	3
Not at all Familiar	Somewhat Familiar	Very Familiar

3. Your degree of familiarity with the company Parmalat:

1	2	3
Not at all Familiar	Somewhat Familiar	Very Familiar

4. Your degree of familiarity with the company WorldCom:

1	2	3
Not at all Familiar	Somewhat Familiar	Very Familiar

5. Your degree of familiarity with the company HealthSouth:

1	2	3
Not at all Familiar	Somewhat Familiar	Very Familiar

6. Your perception of the auditing profession:

1	2	3
Very respected	Neutral	Not very respected

7. What is your age group?

1	2	3	4	5	6	7
Under 20	20 to 29	30 to 39	40 to 49	50 to 59	60 to 69	Over 69

8. What is your gender?

1	2
Male	Female

9. Your college major:

1	2	3
Accounting	Other Business	Other

10. How many years, if any, of accounting experience do you have?

1	2	3	4	5
None	1 to 2	3 to 5	6 to 10	More than 10

Please proceed to the next page.

**The Effects of Offshoring on Jurors' Evaluations of
Auditor Liability and Plaintiff's Awards**

11. How many years, if any, of auditing experience do you have?

1	2	3	4	5
None	1 to 2	3 to 5	6 to 10	More than 10

12. Have you ever been summoned to jury duty?

1	2
Yes	No

13. Have you ever served on a jury?

1	2
Yes	No

14. Have you ever been the plaintiff in a lawsuit?

1	2
Yes	No

15. Have you ever been the defendant in a lawsuit?

1	2
Yes	No

YOU HAVE COMPLETED THE STUDY. THANK YOU FOR PARTICIPATING.