Eldar Maksymov of Cornell University will present “Do Auditor Communication and Manager Action Help Auditors Assess Manager Competence After Control Failure?” on February 7, 2014, 1:30pm in MCRD158.
Do Auditor Communication and Manager Action Help Auditors Assess Manager Competence After Control Failure?

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ABSTRACT:

I examine auditor assessments of manager competence following a failure of internal controls, focusing on two key components of competence implied by COSO’s 2013 Integrated Framework: an understanding of what to do to improve controls and a willingness to do it. Drawing on the Culpable Control Model (Alicke 2000), I predict that factors common in the internal control environment affect auditors’ ability to assess these dimensions of management competence. I perform an experiment that assigns 108 Big-Four audit seniors to one of four conditions in a 2x2 between-participants design, varying auditor communication (whether the auditor previously communicated the potential for a control failure to the manager) and manager action (whether the manager instituted the compensating control). I predict and find that auditors assess the manager’s willingness to improve controls as lower when auditors previously communicated the potential for control failure to the manager and the manager did not institute a compensating control. I also predict and find that auditors assess the manager’s understanding of how to prevent control failures as higher when prior communication from auditors is absent and the manager did not institute a compensating control. In combination, these results suggest that auditor assessments of manager competence can be improved by enhanced communication between auditors and managers, and that a lack of such communication can cause auditors to give managers the benefit of the doubt when that may be unwarranted, thereby overestimating manager competence and discouraging managers from proactively improving internal control.
I. Introduction

Evaluation of managerial competence is fundamental to auditing. For example, auditing guidance requires auditors to assess competence of personnel who perform controls and of personnel who monitor performance of internal controls (PCAOB 2007, AS5, par 46-47), and COSO’s 2013 *Framework* emphasized manager competence as one of the vital components of effective control systems (COSO 2013).

In this paper I examine how two factors common to audit settings interact to affect auditor assessments of manager competence after control failure occurs: (1) prior auditor communication to the manager about the potential for control failure and (2) prior manager action to prevent control failure. I examine audit communication because auditors can choose whether to communicate to managers their concerns about potential control weaknesses. Anecdotal evidence indicates that auditors avoid communicating non-required information to their clients (see e.g., O’Sullivan 2008), and auditing standards only require that auditors communicate control issues that are designated as control deficiencies, significant deficiencies, or material weaknesses (PCAOB 2007). However, AICPA guidance explicitly encourages auditors to communicate non-required information, pointing out that such auditor communications can help managers improve their control systems (AICPA 2008). I examine the effects of manager action because managers can choose whether to act proactively to improve controls, particularly in circumstances in which a control deficiency has not been identified previously by the auditor, and manager actions could affect auditors’ assessments of their competence.

I draw on the Culpable Control Model (CCM; Alicke 2000; Lagnado and Channon,
2008; Shaver 1985) to predict that prior auditor communication about a potential control failure and prior management action to improve controls will interact to affect auditors’ assessments of various dimensions of management competence. In my adaptation of CCM, auditors start with a relatively high belief about management competence and then modify that belief based on the information they have available. Prior communication and prior action affect whether auditors adjust their prior belief because they affect what the auditor can infer about management competence. Specifically, I predict that when auditors previously communicated the potential for control failure to the manager, they will view the manager as more willing to act when the manager previously attempted to improve controls than when the manager made no prior attempt. I also predict that, when auditors did not previously communicate the potential for control failure to the manager, they will view the manager as having a better understanding of how to improve controls when the manager did not previously attempt to improve controls than when the manager previously acted unsuccessfully to improve controls. If supported, these interactions would combine to render managers appearing more competent if they acted to improve controls given prior auditor communication and if they didn’t act to improve controls absent prior auditor communication.

I test my predictions in the context of auditors identifying an error during substantive testing and concluding that the error arose due to a deviation in internal control. When auditors detect errors during substantive testing they are required to assess the impact of those errors on internal control, determining whether the errors arose due to a control deficiency and assessing the severity of the deficiency (PCAOB 2007). Indeed, prior research indicates that material control weaknesses are more likely to be identified as a result of auditors first identifying an
error through substantive testing and then assessing the weakness of controls that allowed the error (Brian and Weber 2012; Gramling et al. 2013; Kinney et al. 2008).

To operationalize this setting, 108 audit seniors from two Big-Four accounting firms assume the role of the audit senior during a hypothetical audit and evaluate competence of the client’s manager who is responsible for internal control. I manipulate two variables in a 2 x 2 between-participants design: whether the client’s manager implemented a compensating control, and whether the auditor previously communicated to the manager the potential for the control failure before the failure occurred. Participants assess two components of the manager’s competence: the manager’s understanding of how to improve internal control and the manager’s willingness to take the necessary action. Participants then provide other data which allow me to consider an alternative explanation for my results based on counter-factual reasoning theory (Gleicher et al 1990).

Results support the predicted interactions between auditor communication and manager action on auditors’ assessments of both management understanding and manager willingness to act. When auditors previously communicated the potential for control failure to the manager, they view the manager as more willing to act when the manager previously attempted to improve controls than when the manager made no prior attempt. When auditors did not previously communicate the potential for control failure, they view the manager as having a better understanding of how to improve controls when the manager did not previously attempt to improve controls than when the manager previously acted unsuccessfully to improve controls. Results and debriefing data do not support explanations based on counterfactual reasoning theory from the psychology literature.
My findings have implications for audit practitioners and regulators. My results indicate that auditor communication helps auditors to make a more informed assessment of manager’s competence in addition to providing helpful information to the manager. Lack of auditor communication about potential control failures may produce the unintended consequences of auditors assessing manager competence higher than is warranted and discouraging managers from proactively improving internal controls under some circumstances. My findings support the AICPA’s encouragement that auditors communicate to managers about potential control failures in circumstances in which they are not currently required to do so. Regulators such as the PCAOB may consider finding ways to reduce auditors’ concerns about making such communications.

My findings also have implications for the growing accounting literature on internal control (e.g., see Asare, Fitzgerald, Graham, Joe, Negangard, and Wolfe 2013 for review). This literature provides evidence that auditor evaluation of internal control is affected by factors such as auditor perception of manager intent to mitigate the problem (e.g., Wolfe, Mauldin, and Diaz 2009), strength of the overall control environment (e.g., Gramling, O’Donnell, and Vandervelde 2010), and presence of an error (e.g., Bedard and Graham 2011). My study contributes to this literature by examining factors that affect auditor evaluation of manager competence in a setting of internal control over financial reporting. My study also examines the effect of another important aspect of the internal control audit environment – auditor communication about potential control failures – on auditor judgment. My findings show that such communication is important in part because it encourages proactive efforts by management to improve controls while also improving auditors’ competence assessments.
The remainder of this paper proceeds as follows. Section II provides background information and develops my hypotheses. Section III and IV discuss my experiment and results, respectively. Section V discusses the results, implications, limitations, and directions for future research.

II. Background and Development of Hypotheses

I first discuss auditor responsibilities regarding the evaluation of manager competence, and then discuss auditor/manager communications about potential control failures. I then adapt the Culpable Control Model (CCM; Alicke 2000; Lagnado and Channon, 2008; Shaver 1985) to predict the effects of auditor communication and manager action on auditor assessment of two aspects of manager competence: manager understanding of how to improve internal controls and manager willingness to act to improve them.

Auditor Evaluation of Manager Competence

Prior literature examines auditor assessment of competence of their subordinates as well as management. Regarding evaluations of the competence of subordinates, prior research finds that auditors’ prior impression of their subordinates affects subsequent evaluations of the subordinates’ performance (see e.g., Bamber 1983; Tan and Jamal 2001, Harding and Trotman 2009).¹

¹ Specifically, Longenecker, Sims, and Gioia (1987) find that a reviewer’s general impression formed from prior interactions may anchor the reviewer’s subsequent performance evaluations of that subordinate. Bamber (1983) asks reviewers to assess the likelihood that the preparers’ conclusions about the internal control system are true and finds that reviewers discount information when they are told that the conclusion is made by less competent preparers. Tan and Jamal (2001) find that average audit managers evaluate outstanding subordinates’ memos more favorably than those of average subordinates, but only when managers know the subordinates’ performance rating. More recently, Harding and Trotman (2009) find that when auditors assess competence of a colleague, they anchor on a specific competence of a familiar colleague or on the average competence of the group from which the unfamiliar colleague is drawn.
Regarding auditor assessment of management competence, prior research finds that auditors rely more on information provided by more competent client managers (e.g., Hirst 1994; Rebele, Heintz, and Briden 1988), view client competence as an important attribute (Messier and Schneider 1988), and decrease audit hours when client competence is higher (e.g., Margheim 1986).

Focusing more on the internal control setting, COSO’s Framework explains that manager competence is important because an effective system of internal control is based on the manager’s use of judgment. COSO’s Framework defines manager competence as follows: “Competence is the qualification to carry out assigned responsibilities. It requires relevant skills and expertise, which are gained largely from professional experience, training, and certifications. It is expressed in the attitude, knowledge and behavior of individuals as they carry out their responsibilities” (COSO 2013). For the purposes of this study, I focus on two distinct components of competence that are implicit in this definition: manager understanding of how to improve internal controls and willingness to act to improve them. Manager understanding encompasses managerial knowledge. Manager willingness encompasses managerial attitude and behavior.

In order to assess the potential that specific controls will fail, auditing guidance requires auditors to assess competence of personnel who perform controls and monitor performance of those controls (PCAOB 2007, AS5, par 46-47), with lower competence indicating a greater

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2 Specifically, Hirst (1994) finds that auditors consider evidence provided by more competent managers to be more diagnostic. Rebele et. al. (1988) find that auditors place more reliance on information when it was developed by a more expert client employee. Messier and Schneider (1988) find that experienced auditors in their sample view competence as the most important attribute of the internal audit function, and Margheim (1986) finds that auditors decrease audit hours when they perceive internal auditors to be more competent.
potential that these controls will fail. More specific to the setting I am examining, low 
competence could be detrimental to the effectiveness of an internal control, particularly when 
the manager in question monitors effectiveness of internal control and is responsible for having 
the understanding and willingness to address potential control problems.

Control failure can also lead auditors to revise their assessments of manager 
competence. Consider a setting common to audits – an auditor believes that the manager 
overseeing controls is reasonably competent and then detects an error arising from a control deviation (see Asare et al 2013). This setting naturally would cause the auditor to consider revising her evaluation of the manager’s competence. My study examines how those competence assessments are affected by two variables: auditor communication and manager action.

**Auditor Communication about Potential Control Failures to Client Managers**

Most auditing engagements repeat for many years (see e.g., Johnson et al 2002; Brooks et al 2012), so auditors have the opportunity to communicate both formally and informally with client personnel. Auditors are required to communicate with clients regarding control issues that are designated as control deficiencies, significant deficiencies, or material weaknesses (PCAOB 2007), and AICPA guidance also explicitly encourages auditors to communicate with clients regarding less severe control issues, as such auditor communications can help managers improve their control systems (AICPA 2008). However, anecdotal evidence indicates that auditors avoid communicating non-required information to their clients, perhaps because auditors are concerned that they will be held more responsible for following up on a problem if they communicate about it to their clients (e.g., Coffee 2004;

In addition to helping managers improve control systems, a more subtle advantage of auditor communication of relatively minor control problems is that communication increases the amount of information about manager competence that the auditor can infer from the absence of a managerial action to address the control problems. I use CCM to make predictions regarding how auditor communication and manager action interact to affect auditor assessment of manager competence.

**Effects of Auditor Communication and Manager Action on Auditor Assessment of Manager Competence**

The Culpable Control Model (CCM; Alicke 2000; Lagnado and Channon, 2008; Shaver 1985) provides a useful perspective when predicting how auditors update their assessments of management competence based on new information. Prior psychology research has supported various aspects of CCM in numerous studies (e.g., Alicke, Buckingham, Zell, and Davis, 2008; Alicke and Rose 2012; Ames and Fiske 2013; Lagnado and Channon, 2008; Fincham and Jaspars, 1983). In addition, a recent accounting study uses CCM to predict juror evaluations of auditor negligence (Backof 2012).

CCM is useful for understanding how people evaluate agents whose actions caused negative events. As part of this evaluation, CCM considers agents’ foresight that their actions may cause negative events to occur and their intent to cause negative events. For example, consider a case in which a wife overdosed her husband’s medication and the husband died from a heart attack (see e.g., Lagnado and Channon, 2008). In this case, evaluators assess the extent to which the wife’s actions caused her husband’s death, which includes evaluating whether she
knew that her action could have a negative outcome and whether she intended to produce that outcome. Fundamental to CCM is that evaluators will base this evaluation on reasonable inferences given the information available to the evaluators.

A key distinction between the internal control context and the standard context in CCM is that the manager who oversees controls typically is not the cause of control failures. Rather, the manager is supposed to prevent control failures by creating a strong internal control system. To perform that task competently, a manager needs to (1) be aware that a potential control failure may occur, (2) understand the nature of the potential control failure and (3) be willing to act to prevent that failure from occurring. I view CCM’s foresight construct as encompassing both manager awareness and understanding, because managers who are aware of potential control failures and understand how to prevent them are equivalent to agents who foresee the potential effect of their actions. I view CCM’s intent construct as encompassing manager willingness to act, because managers who are willing to act upon their understanding of how to improve internal control are equivalent to agents acting with intent to produce the outcomes they foresaw.

A challenging aspect of competence assessment in the internal control auditing context is that the auditor may not know whether the manager should have been aware of a potential control problem. The auditor is better able to revise her assessment of the manager’s understanding and willingness to act if the auditor is sure that the manager was aware of the potential control failure to begin with. I investigate the effects of two factors that affect whether the auditor knows that the manager was aware of a potential control failure: (1) prior communication by the auditor to the manager about a potential failure in internal control and
(2) manager action to improve internal control. I measure the effects of those factors on auditor assessments of manager understanding of the potential control failure and manager willingness to act upon it.

I first propose hypotheses that describe the specific way in which those factors interact to affect auditor understanding and willingness to act. Then I discuss the simple effects that make up those interactions. As shown in Figure 1 and Figure 2, the specific form of the interaction differs between these two dimensions of manager competence.

**H1:** Given a control failure occurred, auditors assess manager understanding of how to prevent control failure as higher when both (1) the auditor did not communicate previously about the potential control failure to the manager, and (2) the manager did not attempt to prevent the control failure.

**H2:** Given a control failure occurred, auditors assess manager willingness to act to prevent control failure as lower when both (1) the auditor communicated previously about the potential control failure to the manager, and (2) the manager did not attempt to prevent the control failure.

I start by discussing simple effects on assessments of manager understanding to prevent control failure, and then discuss simple effects on assessments of manager willingness to prevent it.

*Assessments of Manager Understanding*

To understand the form of the interaction that I predict, start by considering a setting in which an auditor holds a favorable prior belief regarding a manager’s understanding of how to improve internal control and willingness to act to improve internal control. Also assume that the auditor has *not* previously communicated to the manager about the potential for a control failure. A manager action to prevent the control problem conveys that the manager was aware about the potential for a control failure, so the auditor can unambiguously assess the manager
as having low understanding of how to improve internal control. However, a lack of action by the manager to address the control failure is more difficult for the auditor to interpret, because absent prior auditor communication or prior manager action the auditor cannot be sure that the manager was aware that the control problem existed or was willing to act to address it. Therefore the auditor is more likely to default to the auditor’s relatively high prior belief regarding manager understanding (Figure 1, cell D). Overall, given no prior communication by the auditor about the potential for a control weakness, I predict a simple effect of management attempt (i.e., Figure 1 cell D > cell C).

\[ H1a: \text{Given a control failure and that the auditor previously did not communicate the potential for a control failure to the manager, auditors’ assessments of manager understanding of how to improve internal control are higher when the manager did not attempt to implement a compensating control than when the manager did make an attempt.} \]

Now consider the same setting but assume the auditor previously communicated the potential for a control failure. Previous auditor communication about the potential for a control failure (Figure 1, cells A and B) establishes that the manager was aware of the potential problem, so the auditor can attribute the failure by the manager to avert the problem to low understanding of what to do. Specifically, if the manager acted to prevent the control failure, and was unsuccessful in doing so, it is apparent that management did not understand what to do, and if the manager didn’t act, but was aware there was a control problem, either the manager didn’t understand what to do or was unwilling to act. Thus, given that the auditor had previously communicated to the manager about the potential for a control failure, I do not predict a simple effect of manager action on auditor assessment of manager understanding (i.e., Figure 1 cell A ~ cell B).
Comparing between the communication and non-communication settings, this rationale also leads me to predict a simple effect of prior communication given no prior attempt by the manager to prevent the potential control failure (i.e., Figure 1 cell D > cell B). Given no prior attempt, prior communication conveys that the manager was aware of the control problem, while absence of prior communication does not.

H1b: Given a control failure and that the manager did not attempt to implement a compensating control, auditors’ assessments of the manager’s understanding of how to improve internal control are lower when the auditors communicated about the potential for a control failure than when they did not communicate about this potential.

Assessments of Manager Willingness to Act

Once again consider the setting in which an auditor holds a favorable prior belief regarding a manager’s competence and the auditor previously had communicated to the manager about the potential for a control failure. A manager attempt to prevent the potential control failure (Figure 2, cell A) conveys greater willingness to act to improve internal control than does a lack of manager attempt (Figure 2, cell B). This reasoning leads me to predict a simple effect of manager action on auditor assessments of the manager’s willingness to act to prevent internal control, given prior auditor communication (i.e., Figure 2 cell B < cell A).

H2a: Given a control failure, and that the auditor previously communicated the potential for a control failure, auditors’ assessments of manager willingness to act to prevent internal control are higher when the manager attempted to implement a compensating control than when the manager did not make an attempt.

Now consider the same setting but assume the auditor made no prior communication. A manager attempt (Figure 2, cell C) conveys willingness to act. A lack of attempt (Figure 2, cell D) is harder for the auditor to interpret, because it could be due to the manager lacking awareness or understanding of the control problem. Therefore, as with my prediction with
respect to manager understanding, I do not predict a simple effect of manager attempt on auditors’ assessments of manager willingness to act (i.e., Figure 2 cell D ~ cell C).

Comparing between the communication and non-communication settings, this rationale leads me to predict a simple effect of prior communication given no prior management attempt (i.e., Figure 2 cell D > cell B). If the auditor previously communicated the potential for a control failure to the manager, the auditor is more likely to interpret a lack of an attempt to improve controls as indicating a lack of manager willingness to act to improve internal control than if no such prior communication by the auditor occurred.

H2b: Given a control failure and that the manager did not attempt to implement a compensating control, auditors’ assessments of the manager’s willingness to act to improve internal control are lower when the auditors communicated about the potential for a control failure than when they did not communicate about this potential.

Overall these hypotheses combine to suggest an interesting unintended consequence of lack of auditor communication to managers about potential control failures. Given no communication, managers who do not act to proactively improve controls encourage auditors to default to auditors’ prior assessments of manager competence. Assuming that the auditor holds a positive view of the manager, this results in relatively high assessments of manager understanding and manager willingness to act. On the other hand, given prior communication by the auditor, lack of action by the manager results in lower assessments of manager understanding and manager willingness to act.

Alternative Predictions

An alternative theory from the psychology literature, counterfactual reasoning theory (CRT), also may apply in this setting and makes different predictions. I discuss this theory
below and indicate how I can assess whether it also accounts for my results.

The CRT (Gleicher et al 1990; Sherman and McConnell 1995; Kahneman and Miller 1986; Roese 1997) predicts that actions and close outcomes (i.e., “near misses”) will prompt counterfactual thoughts of what could have been done differently to avert a problem, because actions and close outcomes make imagination of alternative outcomes easier. Consistent with the process underlying CRT’s predictions, accounting research finds that auditors assess a lower likelihood of a hypothesized cause of an unusual fluctuation in analytical review when they consider more alternative explanations, because considering more explanations increases the perceived likelihood of alternative explanations and therefore decreases the perceived likelihood of the hypothesized cause (Heiman 1990). Also, a recent accounting study finds that jurors are more likely to judge auditors as negligent for failing to detect fraud when auditors identified a fraud risk and investigated for fraud compared to when auditors did not identify a fraud risk and made no investigation (Reffett 2010). Consistent with CRT, that study finds that jurors focused more in the “near miss” case on what the auditors could have done differently to detect the fraud, and therefore had more negative feelings toward the auditors.

In my setting, CRT would posit that auditor communication and manager action each should decrease auditors’ assessments of management competence (two main effects), because each should increase the chance that the manager could have prevented the control failure and therefore make the control failure that occurred more of a “near miss” that encourages counterfactual thoughts. Greater intensity of counterfactual reasoning should lead to more negative thoughts and less favorable judgments about the manager’s competence (see e.g.,
Therefore, CRT would predict two main effects in which auditor communication and manager action decreases assessments of manager understanding of how to improve internal control and willingness to act upon it. Thus, obtaining the interaction hypothesized in H1 and H2 would be inconsistent with the predictions of CRT. CRT also would predict that the intensity of counterfactual reasoning and affect will mediate the effects of managers’ actions and auditor communication on auditor assessments of manager understanding and willingness to act. Failure to find that intensity of counterfactual reasoning and affect act as mediators would be inconsistent with CRT.

III. Method

Overview and Design

Participants are asked to assume the role of an audit senior responsible for auditing internal controls at an audit client. Participants are provided with a case in which the client changed the sales strategy from a prior year by introducing contracts with bundled services, which complicated revenue recognition and increased the potential of failure of a key control that ensured proper recognition of revenue under each sales contract. Subsequently, auditors detected errors that indicated those control failures and concluded that there was a deficiency in this key control. After learning this information, participants rate the understanding of how to improve controls and willingness to improve controls of the controller who was responsible for overseeing the effectiveness of internal control.

The experiment employs a 2 x 2 between-participants design. One manipulated variable is auditor communication. Participants assigned to the “auditor communication” conditions learn that during the prior year the audit manager communicated to the controller that, given that the...
change in sales strategy may have complex implications for revenue recognition, it is particularly important to ensure that accounting personnel continue to perform the existing key control: “Technical accounting personnel review revenue recognition of contracts for GAAP compliance.” Participants assigned to the “no communication” conditions receive no information about auditor communication.

The other manipulated variable is implementation of a new compensating control by the company’s controller. Participants assigned to the “implementation” conditions learn that the controller implemented a new compensating control under which, for all new contracts with bundled services, the controller personally verified within the billing system that the technical accounting specialists signed off electronically to indicate that they had performed the following key control: “Technical accounting personnel review revenue recognition of contracts for GAAP compliance.” These participants are asked to assume that the compensating control was well designed to verify whether the technical accounting specialists reviewed revenue recognition of contracts for GAAP compliance, and that the audit team tested this new compensating control and found no exceptions in its operation. However, these participants also are informed that the new compensating control did not assess the quality of the reviews performed by these specialists as part of the key control. Participants assigned to the “no implementation” conditions learn that the company’s controller did not implement any new controls.

Participants

Participants are 108 auditors from two Big-Four accounting firms with an average of 3.37 years of experience in public accounting (standard deviation 1.56) and 3.82 audits of internal controls (standard deviation 2.18), with 89 percent already designated as “Audit Seniors” (the
level below Manager). I selected this participant group because auditors at this experience level supervise engagements, interact with the client’s senior managers, and are in the position to evaluate the client managers’ competence and use this assessment to adjust the nature and extent of the audit work performed by their teams.

**Procedure**

The participants completed the task online (89 participants) or using a “paper and pencil” format (19 participants) at the time of their choosing. Figure 3 provides a graphical description of the experimental procedure. Participants first read a brief description of the client and the audit firm prior experience with that client. Participants then read the description of changes from the prior year, which included the manipulations of auditor communication and manager action. All participants then read about the error identified in substantive testing and the resulting control deficiency.

Following the description of the control deficiency, participants rate the manager’s *understanding* of which actions should be taken to improve internal control, given that he is aware of a potential control failure. Participants made their assessments on a 101-point scale (0=very poor understanding and 100=excellent understanding). Participants then rate the manager’s *willingness* to take actions that improve internal control, given that he is aware of a potential control failure. Participants made their assessments on a 101-point scale (0=not at all

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3 In order to meet participant confidentiality requirements of the Big-Four firms, I asked participants to report their experience in public accounting by selecting relevant ranges of experience years (“0-2,” “3-5,” or “6+” years) and audits of internal controls (“0-2,” “3-5,” or “6+” audits). For the purposes of reporting descriptive statistics, I assume that the range “0-2” has the average of 1 year or audit, “3-5” has the average of 4 years or audits, and “6+” has the average of 6.5 years or audits.

4 Eighty-nine auditors were obtained from one firm and 19 were obtained from the second firm. Firm does not interact significantly with any treatment variables and will not be discussed further.
willing to act and 100=very willing to act). All participants also rate how seriously they thought about what the manager could have done differently (0=no serious thoughts and 100=thought very seriously), and how they felt towards the manager (-100=had very strong negative feelings and 100=had very strong positive feelings).

In order to provide data for manipulation checks, participants respond to questions assessing whether they thought that the auditor previously communicated to the client manager about the potential of failure and whether they thought that the client manager implemented a new compensating control. Participants also provide data for within-participants analysis by indicating whether lower manager competence is indicated by an unsuccessful attempt to prevent the control failure or no attempt at all. Participants first make the choice assuming that the auditor did not communicate about the potential of control failure to the manager and then assuming that the auditor communicated about this potential to the manager. The study concludes with participants providing demographic information.

IV. Results

Manipulation Checks

Data from manipulation checks indicate that the case materials successfully manipulated manager action and auditor communication. Eighty percent of the respondents in the “implementation” condition and 84 percent of the respondents in the “no implementation” condition correctly identified whether the controller implemented a new compensating control. Ninety-five percent of the respondents in the “communication” condition and 70 percent of the respondents in the “no communication” condition correctly identified whether the audit manager
communicated to the client manager the potential of control failure.\textsuperscript{5}

**Hypotheses Tests**

**Assessments of Manager Understanding**

The descriptive statistics for auditors’ assessments of the manager’s understanding of how to improve controls are shown in Table 1, Panel A, and graphed in Figure 4. H1 predicts an interaction in which auditors assess the manager’s understanding of how to improve controls as higher given the combination of no auditor communication and no manager action than in the other combinations of the auditor communication and manager action treatments (i.e., Figure 1 cell D > cell A ~ cell B ~ cell C). To test H1, I analyzed participants’ assessments of manager understanding in a two-way ANOVA with the assessed understanding measurement as the dependent variable and the factors “auditor communication” and “manager action” as the independent variables. Table 1, Panel B shows the ANOVA. I performed a contrast test that assigns weights of “+3” for the no communication/no action condition and “-1” for each of the other three conditions (Buckless and Ravenscroft 1990). The analysis is shown in Table 1, Panel C. The contrast is significant (t=1.72, p=0.044, one-tailed), supporting H1.\textsuperscript{6}

H1a predicts a simple effect of manager action on assessed understanding given no auditor communication (i.e., Figure 1 cell D > cell C). To test H1a, I performed a contrast test that assigns weights of “+1” for the no communication/no action condition and “-1” for the no

\textsuperscript{5} The percentage of correct answers to the manipulation check in the “no communication” condition is likely lower than the percentage in the “communication” condition because it is more difficult to identify an event that was absent from the case (i.e., auditor communication) than one that was present. Excluding the participants who failed manipulation checks strengthens all results. To be conservative I report results based on the responses of all participants.

\textsuperscript{6} Table 1, Panel B, shows that the ANOVA interaction is significant (F=3.56, p=0.031, one-tailed). A two-way ANOVA on the rank-transformed assessed understanding measure yields very similar results.
communication/action condition. The analysis is shown in Table 1, Panel C. The contrast is significant (t=1.61, p=0.055, one-tailed), supporting H1a.7

H1b predicts a simple effect of auditor communication on assessed understanding given no manager action (i.e., Figure 1 cell D > cell B). To test H1b, I performed a contrast test that assigns weights of “+1” for the no communication/no action condition and “-1” for the communication/no action condition. The analysis is shown in Table 1, Panel C. The contrast is significant (t=1.87, p=0.032, one-tailed), supporting H1b.8

I did not predict a simple effect of manager action on assessed understanding given prior communication by the auditor (i.e., Figure 1, cell A ~ cell B). Consistent with manager action providing less additional information about manager understanding in that setting I find an insignificant simple effect (t=1.05, p=0.295, two-tailed, untabulated).

I did not predict a simple effect of auditor communication on assessed understanding given manager action (i.e., Figure 1 cell C ~ cell A). Consistent with auditor communication providing less additional information about manager understanding in that setting, I find an insignificant simple effect (t=0.83, p=0.410, two-tailed, untabulated).

Assessments of Manager Willingness to Act

The descriptive statistics for auditors’ assessments of the manager’s willingness to act are shown in Table 2, Panel A, and graphed in Figure 5. H2 predicts an interaction in which auditors assess the manager’s willingness to act to improve controls as lower given the

7 Further supporting H1a, the simple effect of action given no communication in a one-way ANOVA is significant (F=2.47, p=0.061, one-tailed, untabulated), and a one-way ANOVA on the rank-transformed assessed understanding measure yields very similar results.

8 Further supporting H1b, the simple effect of communication given no action in a one-way ANOVA is significant (F=3.66, p=0.031, one-tailed, untabulated), and a one-way ANOVA on the rank-transformed assessed understanding measure yields very similar results.
combination of prior auditor communication and no manager action than in the other combinations of the auditor communication and manager action treatments (i.e., Figure 1 cell B < cell A ~ cell C ~ cell D). As with H1, I analyzed participants’ assessments of manager understanding in a two-way ANOVA with assessed willingness to act as the dependent variable and the factors “auditor communication” and “manager action” as the independent variables. The ANOVA is shown in Table 2, Panel B. I performed a contrast test that assigns weights of “-3” for the communication/no action condition and “+1” for each of the other three conditions (Buckless and Ravenscroft 1990). The analysis is shown in Table 2, Panel C. The contrast is significant (t=3.32, p=0.001, one-tailed), supporting H2.9

H2a predicts a simple effect of manager action on assessed willingness given auditor communication (i.e., Figure 2 cell A > cell B). To test H2a, I performed a contrast test that assigns weights of “+1” for the communication/action condition and “-1” for the communication/no action condition. The analysis is shown in Table 2, Panel C. The contrast is significant (t=3.19, p=0.001, one-tailed), supporting H2a.10

H2b predicts a simple effect of auditor communication on assessed willingness given manager action (i.e., Figure 2 cell D > cell B). To test H2b, I performed a contrast test that assigns weights of “+1” for the no communication/no action condition and “-1” for the communication/action condition. The analysis is shown in Table 2, Panel C. The contrast is

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9 Table 2, Panel B, shows that the ANOVA interaction of the two independent variables is significant (F=5.43, p=0.011, one-tailed). A two-way ANOVA on the rank-transformed assessed willingness measure yields very similar results.

10 Further supporting H2a, the simple effect of action given communication in a one-way ANOVA is significant (F=10.69, p=0.001, one-tailed), and a one-way ANOVA on the rank-transformed assessed willingness measure yields very similar results.
significant \((t=2.48, p=0.008, \text{ one-tailed})\), supporting H2b.\(^{11}\)

I did not predict a simple effect of manager action on assessed willingness given no prior communication by the auditor (i.e., Figure 2, cell C \sim cell D). Consistent with manager action providing less additional information about manager willingness in that setting, I find an insignificant simple effect \((t=0.13, p=0.898, \text{ two-tailed, untabulated})\).

I did not predict a simple effect of auditor communication on assessed willingness given manager action (i.e., Figure 2 cell C \sim cell A). Consistent with auditor communication providing less additional information about manager willingness in that setting, I find an insignificant simple effect \((t=0.86, p=0.390, \text{ two-tailed, untabulated})\).

**Counterfactual Reasoning Theory**

My results are inconsistent with the predictions of the CRT, which suggests that auditor communication and manager action would lower assessed competence because they would lead to higher intensity of counterfactual thoughts, more negative affect toward the manager, and a lower assessment of competence. Contrary to the predictions of the CRT, I find that the effect of manager action on assessed understanding (H1) and on assessed willingness (H2) depends on prior communication by the auditor. In particular, given auditor communication manager action leads to *higher* assessed willingness (H2a), inconsistent with the CRT.

In addition, inconsistent with the predictions of the CRT, measures of intensity of counterfactual thoughts and affect do not mediate the effects of auditor communication and

\(^{11}\) Further supporting H2b, the simple effect of communication given no action in a one-way ANOVA is significant \((F=7.81, p=0.004, \text{ one-tailed})\), and a one-way ANOVA on the rank-transformed assessed willingness measure yields very similar results.
manager action on assessed understanding or willingness. More specifically, auditor communication is not associated with the intensity of counterfactual thoughts (F=0.68, p=0.413) or with affect (F=1.85, p=0.177). Manager action is not associated with the intensity of counterfactual thoughts (F=0.15, p=0.702), and has a significant positive association with affect (F=3.20, p=0.077) that is contrary to the predictions of the CRT that the manager’s unsuccessful attempt to prevent the control failure would cause a greater negative affect.

**Analysis of Within-Participants’ Responses**

After participants made assessments of manager understanding and willingness, they were asked to consider all four experimental conditions and indicate whether manager action or absence of manager action indicates lower understanding and willingness of the manager. Participants were asked to make this selection assuming first that the auditor did not communicate to the client manager the potential for control failure and, second, that the auditor did communicate this to the client manager. Participants were also able to select the “no difference” option.

These within-participants results are shown in Table 3. The results indicate that participants view lack of manager action as indicating a lower understanding (53 vs. 25 given communication and 62 vs. 22 absent communication) and lower willingness (85 vs. 10 given communication and 87 vs. 9 absent communication) than an (unsuccessful) action (p=0.000 for all comparisons). These results indicate that when a within-subjects presentation of the

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12 All mediation analyses were at 10% level in SPSS: a bootstrap test with 5,000 iterations and Sobel’s test, using the macro downloaded on 2/1/2013 from Andrew Hayes’ website (http://afhayes.com/spss-sas-and-mplus-macros-and-code.html) and described at Preacher and Hayes (2008) and Zhao et al (2010).

13 I used nonparametric one-sample test in SPSS version 21 to assess whether the number of auditors selecting the “no manager action” scenario is greater than the number of auditors selecting the “manager action” scenario.
communication and action treatments clarifies the options that were available to managers, auditors believe the manager should have acted to improve controls, regardless of prior auditor communication. When combined with the between-subjects results discussed earlier, these results highlight that auditors in the no-communication treatment do not spontaneously hold managers accountable for not acting, but will do so if auditor communication or other information suggest that managers should have acted.

V. Discussion

I report the results of an experiment that provides evidence that auditors’ prior communication to managers about the potential for control failure affects how the presence or absence of manager action to prevent a failure influences auditor assessment of two key components of manager competence: understanding of how to improve internal control and willingness to act to improve internal control. Based on the Culpable Control Model (CCM; Alicke 2000; Lagnado and Channon, 2008; Shaver 1985), I predict and find specific patterns for these interactions.

With regards to auditor assessments of manager understanding, I predict and find that, absent prior communication, auditors view the manager who did not make an attempt to prevent the control failure as having a higher understanding of how to improve internal control than the manager who made an unsuccessful attempt. With regards to auditor assessment of managerial willingness, I predict and find that, given prior communication, auditors view the manager who did not make an attempt to prevent the control failure as having lower willingness to act to improve internal control than the manager who made an unsuccessful attempt. For both understanding and willingness, auditors penalize managers more for failing to act to improve
controls when the auditor previously communicated the potential for control failure to the manager.

These results indicate that auditors who lack information relevant to assessing manager competence may tend to give the manager the benefit of the doubt. Absent prior auditor communication about control risks, an auditor could assess a manager as having a higher understanding following a control failure if the manager did not attempt to improve controls than if the manager made the attempt. The auditor could also assess a manager as having a higher willingness to act than may be warranted. Thus, auditor assessment of manager competence absent good auditor/manager communication might discourage managers from proactively improving controls. Prior communication to the manager about the potential for control failure mitigates these effects.

These results are consistent with the predictions of CCM: auditors base their evaluations on reasonable inferences from prior communications to management and from management actions. However, one limitation of my results is that they only examine a setting in which the auditor holds a favorable prior belief regarding management competence. Future research could extend my findings to a setting in which an auditor has a less favorable prior belief. In that setting, “no news is bad news”, and managers may be more encouraged to act proactively to improve auditors’ assessments of manager competence.

My results are inconsistent with the predictions of CRT, which anticipates that auditor communication and manager action lower assessed competence because they lead to higher intensity of counterfactual thoughts and more negative affect toward the manager. Thus, my results provide some insight into the boundaries of the CRT.
From a practice perspective, the challenge is to make absence of manager action more obvious in the competence assessment process. As suggested by my results, one way to do this in practice is for auditor to communicate the potential for a known problem to the manager, so it is clear that the manager should act to prevent the problem before it occurs. Enhanced communication about potential control problems could reduce the auditor’s tendency to give the manager the benefit of the doubt when it may be unwarranted and encourage managers to proactively attempt to improve internal controls. While the AICPA explicitly allows auditors to communicate minor control issues to their clients, anecdotal evidence indicates that auditors are reluctant to do so. Regulators such as the PCAOB may consider finding ways to reduce auditors’ concerns about making such communications to client managers.

The results of my study suggest additional directions for future research. Studies could examine how assessed competence of managers affects auditor evaluation of internal control, professional skepticism, and other audit judgments. Studies could also examine whether auditor tendency to give the benefit of the doubt to managers when relevant information is lacking applies to other settings such as audit of accounting estimates and going-concern judgments.
REFERENCES


O’Sullivan, Kate. Can This Relationship Be Saved? Auditors and CFOs aren't the friends they once were, but they are working out their differences. *CFO Magazine*. CFO Publishing Corporation, 1 May 2008. Web. 27 April 2013.


FIGURE 1
Experimental Design and Predictions – Assessment of Managers’ Understanding of How to Improve Internal Control

<table>
<thead>
<tr>
<th>Auditor Communication: Did the auditor communicate about the potential for control failure to the manager during the prior year?</th>
<th>Manager Action: Did the manager attempt to address the problem by instituting a compensating control?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>Cell C</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>Cell B</td>
</tr>
<tr>
<td>No</td>
<td>Cell D</td>
</tr>
</tbody>
</table>

This figure illustrates the experimental design and predictions with respect to auditor assessment of manager’s understanding of how to improve internal control. The cells correspond to the hypotheses as follows:

H1: D>A>B>C
H1a: D>C
H1b: D>B
### FIGURE 2
Experimental Design and Predictions – Assessment of Managers’ Willingness to Act to Improve Internal Control

<table>
<thead>
<tr>
<th>Auditor Communication: Did the auditor communicate about the potential for control failure to the manager during the prior year?</th>
<th>Manager Action: Did the manager attempt to address the problem by instituting a compensating control?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Yes</td>
<td>Cell A</td>
</tr>
<tr>
<td></td>
<td>Assessment of <em>willingness</em> is relatively <strong>high</strong></td>
</tr>
<tr>
<td>No</td>
<td>Cell C</td>
</tr>
<tr>
<td></td>
<td>Assessment of <em>willingness</em> is relatively <strong>high</strong></td>
</tr>
</tbody>
</table>

This figure illustrates the experimental design and predictions with respect to auditor assessment of managers’ *willingness* to act to improve internal control. The cells correspond to the hypotheses as follows:

- H2: B<A~C~D
- H2a: A>B
- H2b: D>B

---

32
FIGURE 3
Experimental Procedure

Condition A:
Description of
- auditor communication
- manager action

Condition B:
Description of
- auditor communication

Condition C:
Description of
- manager action

Condition D:
No additional information

Description of
- the error
- the control deficiency

Assessment of manager’s
- understanding of how to improve internal controls
- willingness to act

Debriefing and demographic questions
FIGURE 4
Experimental Results – Assessment of Managers’ 
Understanding of How to Improve Internal Control (Means)

This figure illustrates the effects of “auditor communication” and “manager action” on assessment of managers’ understanding of how to improve internal control. The experimental design is summarized in Figure 1.

FIGURE 5
Experimental Results – Assessment of Managers’ 
Willingness to Act to Improve Internal Control (Means)

This figure illustrates the effects of “auditor communication” and “manager action” on assessment of managers’ willingness to act to improve internal control. The experimental design is summarized in Figure 2.
**TABLE 1**  
Descriptive Statistics, ANOVA, and Planned Contrasts for Assessment of Managers’ *Understanding* of How to Improve Internal Control

**Panel A: Descriptive Statistics for Assessment of Managers’ *Understanding*  
(Mean, (Standard Deviation), and [Median])**

<table>
<thead>
<tr>
<th>Auditor Communication</th>
<th>Manager Action (Implementing Compensating Control)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>Yes</td>
<td>50.24</td>
</tr>
<tr>
<td></td>
<td>(17.33)</td>
</tr>
<tr>
<td></td>
<td>[50.00]</td>
</tr>
<tr>
<td></td>
<td>n = 25</td>
</tr>
<tr>
<td>No</td>
<td>45.73</td>
</tr>
<tr>
<td></td>
<td>(22.16)</td>
</tr>
<tr>
<td></td>
<td>[40.00]</td>
</tr>
<tr>
<td></td>
<td>n = 26</td>
</tr>
</tbody>
</table>

**Panel B: ANOVA for Assessment of Managers’ *Understanding***

<table>
<thead>
<tr>
<th>Source</th>
<th>Type III SS</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication</td>
<td>176.42</td>
<td>1</td>
<td>176.42</td>
<td>0.47</td>
<td>0.496</td>
</tr>
<tr>
<td>Action</td>
<td>63.02</td>
<td>1</td>
<td>63.02</td>
<td>0.17</td>
<td>0.684</td>
</tr>
<tr>
<td>Communication × Action †</td>
<td>1,343.88</td>
<td>1</td>
<td>1,343.88</td>
<td>3.56</td>
<td>0.031**</td>
</tr>
<tr>
<td>Error</td>
<td>39,295.98</td>
<td>104</td>
<td>377.85</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Panel C: Planned Contrasts for Assessment of Managers’ *Understanding***

<table>
<thead>
<tr>
<th>Contrasts</th>
<th>t-statistic</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>H1: Auditor communication x manager action † [-1, -1, -1, +3]</td>
<td>1.72</td>
<td>0.044**</td>
</tr>
<tr>
<td>H1a: Manager action given no auditor communication † [0, 0, -1, +1]</td>
<td>1.61</td>
<td>0.055*</td>
</tr>
<tr>
<td>H1b: Auditor communication given no manager action † [0, -1, 0, +1]</td>
<td>1.87</td>
<td>0.032**</td>
</tr>
</tbody>
</table>

*One-tailed equivalent test

* **Significant at 0.1 and 0.05 level, respectively

This table provides descriptive statistics, ANOVA, and planned contrast tests for the effects of “auditor communication” and “manager action” on auditor’s assessments of whether the manager understands what actions to take to improve controls. Panel A presents means, standard deviations, and medians. Auditors assessed manager understanding on a 101-point scale (0=very poor understanding and 100=excellent understanding). The experimental design is summarized in Figure 1.
TABLE 2
Descriptive Statistics, ANOVA, and Planned Contrasts for Assessment of Managers’ Willingness to Act to Improve Internal Control

Panel A: Descriptive Statistics for Assessment of Managers’ Willingness (Mean, (Standard Deviation), and [Median])

<table>
<thead>
<tr>
<th>Auditor Communication</th>
<th>Manager Action (Implementing Compensating Control)</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>60.48</td>
<td>(21.18)</td>
<td>[60.00]</td>
</tr>
<tr>
<td></td>
<td>(21.18)</td>
<td></td>
<td></td>
<td>[60.00]</td>
</tr>
<tr>
<td></td>
<td>No</td>
<td>55.88</td>
<td>(21.19)</td>
<td>[55.00]</td>
</tr>
<tr>
<td></td>
<td>(21.19)</td>
<td></td>
<td></td>
<td>[56.00]</td>
</tr>
</tbody>
</table>

n = 25 n = 30

Panel B: ANOVA for Assessment of Managers’ Willingness

<table>
<thead>
<tr>
<th>Source</th>
<th>Type III SS</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication</td>
<td>418.64</td>
<td>1</td>
<td>418.64</td>
<td>1.16</td>
<td>0.284</td>
</tr>
<tr>
<td>Action</td>
<td>1,665.12</td>
<td>1</td>
<td>1,665.12</td>
<td>4.61</td>
<td>0.034</td>
</tr>
<tr>
<td>Communication × Action</td>
<td>1,961.09</td>
<td>1</td>
<td>1,961.09</td>
<td>5.43</td>
<td>0.011**</td>
</tr>
<tr>
<td>Error</td>
<td>37,589.43</td>
<td>104</td>
<td>361.44</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Panel C: Planned Contrasts for Assessment of Managers’ Willingness

<table>
<thead>
<tr>
<th>Contrasts</th>
<th>t-statistic</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>H2: Auditor communication x manager action †</td>
<td>3.32</td>
<td>0.001***</td>
</tr>
<tr>
<td>H2a: Manager action given auditor communication †</td>
<td>3.19</td>
<td>0.001***</td>
</tr>
<tr>
<td>H2b: Auditor communication given no manager action †</td>
<td>2.48</td>
<td>0.008***</td>
</tr>
</tbody>
</table>

†One-tailed equivalent test
***Significant at 0.01 level

This table provides descriptive statistics, ANOVA, and planned contrast tests for the effects of “auditor communication” and “manager action” on auditor’s assessments of whether the manager was willing to act improve controls. Panel A presents means, standard deviations, and medians. Auditors assessed manager willingness on a 101-point scale (0 = very poor willingness and 100 = excellent willingness). The experimental design is summarized in Figure 1.
**TABLE 3**

Descriptive Statistics – Within-Participants Comparisons of “Manager Action” and “No Manager Action” Scenarios When Auditor Communication is “Yes” vs. “No” (counts: “no manager action” scenario | “manager action” scenario | no difference)

<table>
<thead>
<tr>
<th>Auditor Communication</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poorer understanding of how to improve internal control</td>
<td>53</td>
<td>25</td>
</tr>
<tr>
<td>Lower willingness to act</td>
<td>85</td>
<td>10</td>
</tr>
<tr>
<td>Greater foreseeability of the control failure</td>
<td>9</td>
<td>52</td>
</tr>
</tbody>
</table>

This table provides descriptive statistics for the counts of auditors selecting the “manager action” scenario, “no manager action” scenario, or “no difference” option in deciding which of the scenarios suggests poorer managerial understanding of how to improve internal control, lower managerial willingness to act, and greater foreseeability of the control failure. Failures to respond were not considered (<3% of auditors).
ACADEMIC BACKGROUND

Cornell University
Samuel Curtis Johnson Graduate School of Management
Ph.D., Accounting (Expected 2014)
Minor Concentrations: Psychology and Statistics
M.S., Management (2014)

Brigham Young University
Marriott School of Management
MAcc (2004)
B.S., Accounting (2003)

Certified Public Accountant (C.P.A.)
Virginia (2007)

WORK EXPERIENCE

Cornell University
Samuel Curtis Johnson Graduate School of Management
Research Assistant for Mark Nelson (2009 – Present)
Teaching Assistant for the following professors/classes:
   Robert Swieringa (Corporate Governance, 2013, 2012)
   Craig Nichols (Advanced Financial Statement Analysis, 2012)
   Bob Libby and Margaret Shackell-Dowell (Financial Accounting, 2011)
   Ron Hilton (Managerial Accounting, Distance Learning Format, 2010)

Deloitte, LLP
Audit Staff, Dallas, TX, US (2004 – 2005)
A. Dissertation

“Auditor Assessment of Manager Competence After Control Failure: Effect of Auditor Communication and Management Action” (Chair: Mark Nelson. Committee members: Rob Bloomfield, Dennis Regan, Giles Hooker, and Jacob Bien)

ABSTRACT: I examine auditor assessments of manager competence following a failure of internal controls, focusing on two key components of competence implied by COSO’s 2013 Integrated Framework: an understanding of what to do to improve controls and a willingness to do it. Drawing on the Culpable Control Model (Alicke 2000), I predict that factors common in the internal control environment affect auditors’ ability to assess these dimensions of management competence. I perform an experiment that assigns 108 Big-Four audit seniors to one of four conditions in a 2x2 between-participants design, varying auditor communication (whether the auditor previously communicated the potential for a control failure to the manager) and manager action (whether the manager instituted the compensating control). I predict and find that, when auditors previously communicated the potential for control failure to the manager, auditors assess the manager as more willing to improve controls when the manager instituted a compensating control in an (unsuccessful) attempt to prevent control failure. I also predict and find that, absent prior communication, auditors assess the manager as having less understanding of how to prevent control failures when the manager instituted a compensating control than when the manager made no attempt. In combination, these results suggest that auditor assessments of manager competence can be improved by enhanced communication between auditors and managers, and that a lack of such communication can cause auditors to give managers the benefit of the doubt when that may be unwarranted, thereby overestimating manager competence and discouraging managers from proactively improving internal control.

B. Working Papers


ABSTRACT: We report the results of an experiment that examines auditors’ planning judgments relevant to determining the accuracy of fair values reported in financial statements. In the experiment, 49 experienced audit managers budget time for 15 procedures relevant to auditing a level 3 asset in the fair value hierarchy. We test the effects of three features present in the typical fair value auditing context: the frame of the audit procedure (e.g., varying whether auditors assess whether management’s assumptions are vs. are not appropriate), the pressure for audit efficiency communicated to the auditor (high vs. low), and the extent to which the audit quality of a procedure can be verified ex post (rated by each participant for each procedure). Results indicate significant main effects of frame and efficiency pressure on auditors’ planning judgments, and a significant interaction between frame and procedure verifiability, with a negative frame increasing auditors’ planned effort
more with respect to procedures for which audit quality is less verifiable. Results also indicate that frame and efficiency pressure do not affect auditors’ estimates of achieved audit risk and that auditors are not aware how frame affects their judgments. Overall, the results suggest the importance of all three factors in audit planning and the importance of procedure frame in auditing standards and audit firm guidance.


ABSTRACT: We investigate how audit quality and the timing of jurors’ assessment of the necessary standard of prudent care (“SOC”) combine to affect jurors’ judgments of auditor negligence. In two experiments we manipulate between-jurors the level of audit quality (low vs. high) and the timing of jurors’ assessment of SOC (before vs. after jurors learn audit quality). The experiments differ as to whether the case facts encourage jurors to default to a relatively high or low SOC absent knowledge of audit quality. In both experiments we predict and find that, when jurors do not know the audit quality level at the time they assess SOC, higher audit quality reduces the likelihood that auditors are found negligent, because higher audit quality is more likely to exceed jurors’ assessments of SOC. In contrast, when jurors know the audit quality level at the time they assess SOC, jurors anchor SOC on audit quality, so higher audit quality may not reduce the likelihood that auditors are found negligent due to the offsetting effects of audit quality (decreasing negligence judgments directly but increasing them indirectly through SOC). The implications of this mediation differ depending on the SOC to which jurors default given no knowledge of audit quality. When jurors default to a relatively high SOC as in Experiment One, anchoring SOC on audit quality helps low-quality auditors to avoid a negligence verdict by reducing SOC. Precluding anchoring does not help high-quality auditors, who still face a high SOC. On the other hand, when jurors default to a relatively low SOC as in Experiment Two, anchoring SOC on audit quality doesn’t help low-quality auditors, and precluding anchoring helps high-quality auditors to avoid a negligence verdict because they are more likely to exceed the low default SOC. These results contribute to the juror decision making literature and have implications for audit practitioners, regulators and litigators.

C. Presentations

Brigham Young University, 2012

D. Conference/Panel Activity

AAA Annual Conference, Participant, January 2013
University of Illinois Symposium on Audit Research, Invited Participant, October 2012
Brigham Young University Accounting Symposium, Presenter, September 2012
Center for Audit Quality Symposium, Invited Participant, August 2011
AAA Annual Conference, Participant, August 2011
Accounting Doctoral Scholar/AICPA Conference, Panelist, November 2010
E. Press Coverage

Center for Audit Quality Newsroom
Deloitte Life Magazine
Johnson News, Cornell University

PROFESSIONAL SERVICE

Faculty Liaison (elected by PhD students), Samuel Curtis Johnson Graduate School of Management, Cornell University, 2010-2013
Research Summary Writer and Reviewer, American Accounting Association Auditing Section Research Summary Database Project, 2011
Member of the Board of Directors of Dallas-Fort Worth Management Society (Recruiting/Marketing Committee), 2005-2007

TEACHING

A. Primary Areas of Interest

Auditing and Assurance Services
Financial Accounting
Experimental Research
Managerial Accounting

B. Courses Taught Previously

Introductory Financial Accounting
  Spring 2012 (Ratings: 4.58 out of 5, where 1 = “ Poor” and 5 = “Excellent”)
  Fall 2011 (Ratings: 4.70 out of 5, where 1 = “ Poor” and 5 = “Excellent”)

HONORS and AWARDS

AAA/Deloitte/J. Michael Cook Doctoral Consortium Fellow, June 2013
AICPA/Accounting Doctoral Scholar Award, 2009-2013
Center for Audit Quality Research Award, May 2011
Cum Laude, Brigham Young University, 2003
Office of Research and Creative Activities’ Research Grant, Brigham Young University, 2002
Dean’s Honor List, Brigham Young University, 2001
PROFESSIONAL AFFILIATIONS

American Accounting Association, 2013-present
CPA, Virginia, 2007-present
American Institute of Certified Public Accountants, 2004-present
CPA, Washington, D.C., 2007-2010
CPA, Texas, 2005-2009
Texas State CPA Society, 2005-2006

REFERENCES

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Robert Bloomfield
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Phone: 607-255-9407

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David A. Thomas Professor of Management
Email: rl54@cornell.edu
Phone: 607-255-3348