

## **The Effect of National Office and External Inspection on Audit Partner's Judgment**

**Yi Luo CPA, CA**

Stephen J. R. Smith School of Business  
Queen's University  
Kingston, Ontario, Canada K7L 3N6  
[yi.luo@queensu.ca](mailto:yi.luo@queensu.ca)

May 2021

I thank the reviewers at the CAAA *AP* Symposium for valuable suggestions. I am grateful for the guidance, suggestions, and support from my dissertation chair Steve Salterio, as well as committee members Pam Murphy and David Saunders. I appreciate Stephanie Donohue and Bailey Church for their help with the experiment instrument, and I thank the auditors and audit firms for generously taking their time to participate in the experiment. I thank workshop participants at Concordia University, Hong Kong Polytechnic University, KU Leuven, Nanjing University, Queen's University, Ryerson University, Shanghai University of Finance and Economics, University of Guelph, Washington State University, participants at the 2018 CAAA Craft of Accounting Research workshop and Wilfred Laurier University's Lazaridis School Accounting Symposium, Martine Cools, Steve Dannemiller (discussant), Yu Hou, Kim Tran Nguyen, Bertrand Malsch, Alan Webb (discussant), and Mike Welker for their comments.

## **The Effect of National Office and External Inspection on Audit Partner's Judgment**

### **ABSTRACT**

This paper investigates how efforts to improve audit quality within audit firms and outside of audit firms collectively affect audit partner's judgment. Externally, audit regulators conduct inspections and provide feedback to auditors with the goal of improving audit quality. Internally, national office supports auditor partners to make judgment and prepare for inspections. However, we know little about how the two forces interact. Using a between subject experiment with audit partners and senior managers, I predict and find that when the regulator is antagonistic (i.e., when audit regulator's feedback anchors on failure), audit partners working with a collaborative national office are less committed to their negotiation goals than those working with a prescriptive national office, and are more likely to rely on integrative negotiation strategy (Expand the Agenda) that seeks to benefit both the client and the auditor than those working with a prescriptive national office. However, when the regulator is less antagonistic, audit partners are more committed to reducing client's aggressive net income. My findings demonstrate national office's move towards a more collaborative consultation approach could have negative consequences under an antagonistic regulatory environment, but they may be mitigated when the regulatory environment is less antagonistic.

## I. INTRODUCTION

Audit quality has been a key focus of audit regulators for the last 20 years (Public Company Accounting Oversight Board (PCAOB) 2002; Canadian Public Accountability Board (CPAB) 2018). To improve audit quality, audit regulators perform detailed inspections on audit firms (Dowling et al. 2018; Johnson et al. 2018; Westermann et al. 2018), and audit firms rely on national office to support auditor partners' judgment and to manage the inspection process (Aghazadeh et al. 2020). Yet we know little about how this combination of efforts affects key audit judgments, including how the auditor and client management resolve auditor proposed accounting adjustments that differ from the client's initial accounting positions (Choudhary et al. 2018). As proposed accounting adjustments may contain both clear-cut misstatements and more subjective "grey areas" requiring judgment, resolution of proposed accounting adjustments often requires negotiation between the auditor and the client management (Gibbins et al. 2001). Audit partner's judgment at the onset of negotiation, such as how committed the audit partner is to her goal of adjusting accounting numbers and her choice of negotiation strategy, affect the negotiation process, negotiators' relationship, the ultimate outcome, and future negotiations (Pruitt and Carnevale 1994; Sanchez et al. 2007; Trotman et al. 2009; Gibbins et al. 2010). In this study, I draw on regulatory focus theory to examine how audit partner's judgment at the onset of the negotiation is affected by national office's approach to consultations and audit regulator's feedback characteristics.

Regulatory focus theory is based on the insight that circumstances individuals face can trigger a prevention focus or a promotion focus, and the triggered regulatory focus affects how individuals perceive and pursue their goals. In negotiations, promotion focused individuals are less committed to their negotiation goal than prevention focused individuals (Molden and Hui

2011). Promotion focused individuals are also more likely than prevention focused negotiators to rely on integrative negotiation strategies that expand the pie through trade-offs and problem solving than distributive strategies that divide the pie through contending and conceding (Galinsky et al. 2005).<sup>1</sup> Negotiator's regulatory focus can be activated, for example, by receiving feedback anchored on failure or success (Van Dijk and Kluger 2004, 2011) and by leader emphasis on avoiding failure or pursuing success (Brockner and Higgins 2001; Johnson et al. 2017). Thus, theoretically, different contextual factors may trigger congruent or incongruent regulatory focus. For instance, in the audit setting, an auditor may interact with a national office that emphasizes obligations and responsibilities (as opposed to ideals and aspirations), receive feedback from regulators on presence or absence of failure in her compliance, but the same auditor may have coworkers who are promotion focused, always striving towards the best solution (as opposed to avoiding mistakes). However, there is little research on how multiple, regulatory-focus-inducing contextual cues interact. Thus, I also explore cognitive and motivational implications when contextual factors highly salient in the auditing environment – audit firm's national office and audit inspections – activate congruent vs. incongruent regulatory focus.

In large audit firms, national office improves audit quality through assisting partners in making complex and difficult audit judgments (Salterio and Denham 1997; Aghazadeh et al. 2020; Chen and Choudhary 2020). Post-SOX, national office is also involved in preparing auditors for audit inspections (Malsch and Couchoux 2020). Consultations with national office in

---

<sup>1</sup> Researchers distinguish between two general negotiation strategies: integrative (win-win) and distributive (win-lose). Tactics that characterize integrative strategy includes Problem Solve (searching for a new solution that meets both negotiation parties' needs) and Expand the Agenda (adding new issues to the negotiation to allow both parties to gain something). Tactics that characterize distributive strategy includes Contend (directly and forcefully challenge the other party), Concede (giving in to induce reciprocal concessions) and Compromise (splitting the differences) (Sanchez et al. 2007; Gibbins et al. 2010).

the audit process are viewed as an essential component of the audit by audit firms (EY 2019; PwC 2019) and as an audit quality indicator that audit regulators encourage (PCAOB 2015). Prior research shows that national office can take different approaches to supporting local office partners through consultations (Salterio and Denham 1997; Westermann et al. 2018; Aghazadeh et al. 2020). At one extreme, national office can be prescriptive, focusing on partners' not having deficiencies in their engagements that would draw negative inspection findings from audit regulators such as the PCAOB. At the other extreme, national office can act in a collaborative manner with partners, focusing on supporting audit partners to develop the best resolution to differences with client management that satisfy multiple stakeholders and within constraints of professional standards (Gold et al. 2012; Aghazadeh et al. 2020). I hypothesize that a prescriptive national office activates a prevention focus in audit partners, whereas a collaborative national office activates a promotion focus. Given their promotion focus, I expect audit partners who work with a collaborative national office are i) more likely to use integrative negotiation strategies that seek to create win-win solutions, and ii) less committed to their negotiation goal than those working with a prescriptive national office.

I also examine whether the impact of national office approach to consultations is contingent upon characteristics of inspection feedback from audit regulators. I contrast antagonistic inspection feedback that anchors on finding and reporting audit failure (Dowling et al. 2018; Johnson et al. 2018; Westermann et al. 2018) with feedback anchored on finding and reporting opportunities of improvement, while holding constant the underlying issues discovered during inspection. I expect that feedback anchored on failure activates prevention focus, whereas feedback anchored on opportunities of improvement activates promotion focus. I explore whether experiencing fit, that is, when the national office approach and the inspection feedback

activate the same type of regulatory focus, increase auditor's goal commitment and change their negotiation strategy choice.

I test my expectations in a  $2 \times 2$  between-participant experiment where audit partner and senior manager participants prepare to resolve accounting adjustments with a hypothetical client in a year-end audit. The unadjusted accounting differences include both clear-cut errors and subjective estimates that the audit team believe lead to overstated income. I manipulate national office's approach to consultations as *prescriptive*, focusing on not being caught as deficient, or *collaborative*, focusing on supporting partners to come up with the best solution within the constraints of audit standards. Holding constant the underlying issues identified during inspection, I contrast an antagonistic regulator, one that focuses on finding and reporting *failure* in auditor's work, with one that focuses on finding and reporting opportunities of *improvement* in auditors' work. I measure audit partners' commitment to the goal of reducing the client's overstated income, as well as their intended reliance on integrative negotiation strategies (specifically, Expand the Agenda and Problem Solve) and distributive negotiation strategy (specifically, Concede) (Gibbins et al. 2010).

I find that when audit regulator is antagonistic (that is, its inspection feedback anchors on identifying and criticizing failure), audit partners are less committed to the goal of reducing aggressive accounting income when the national office is collaborative than when the national office is prescriptive. With regards to negotiation strategy, audit partners working with a collaborative national office are more likely than those working with a prescriptive national office to resort to integrative negotiation strategy (Expand the Agenda) that seeks to benefit both the client and the auditor. However, given the same collaborative national office, I find that

reframing regulator's inspection feedback from failure to opportunities of improvement increases audit partners' commitment to the goal of reducing aggressive income.

My study has implications for academics, practitioners, and regulators. As national offices in large audit firms move towards a more collaborative approach to consultations (Aghazadeh et al. 2020), my study provides theory-consistent evidence that such a move could have unintended negative consequences, especially in an antagonistic regulatory environment that often characterizes PCAOB (Dowling et al. 2018; Johnson et al. 2018; Westermann et al. 2018). As researchers call for changes in audit regulatory approach (Peecher et al. 2013), my study provides evidence that, holding constant the underlying audit issues identified, a subtle change from reporting and highlighting inspection feedback as failures to opportunities of improvement could increase audit partners' commitment to reducing aggressive accounting and increase their motivation to rely less on negotiation strategies that benefit the clients. As such, my study extends prior literature that documents limitations to PCAOB's current inspection approach (Glover et al. 2009; Glover et al. 2019; Stuber and Hogan 2020). By drawing on regulatory focus theory, I also provide evidence on why auditors appear to gravitate towards the minimum bar by audit standards rather than strive to improve audit quality (Aobdia 2018). Lastly, I extend regulatory focus theory literature by examining how multiple contextual cues that activate (in)congruent regulatory focus affect individuals' pre-negotiation judgment.

The remainder of this paper is organized as follows. I review relevant literature and develop my hypotheses in Section II. Section III and IV describe the experiment design and present the results from the experiment. Section V concludes with discussion of implications of this study.

## II. HYPOTHESIS DEVELOPMENT

### Background

The past two decades saw an increasing emphasis on audit quality, and as a result, a significant amount of resources both within the audit firms and outside of audit firms have been devoted to the goal of improving audit quality. Across the globe, external audit regulators pursue the goal of improving audit quality through periodic inspections over auditors' working papers (U.S. House of Representatives 2002; PCAOB 2002; CPAB 2018). Within audit firms, there is an increase push towards consultations with national office, who "provides technical expertise in accounting, auditing, and regulatory support to our engagements" (Deloitte 2019; EY 2019; PwC 2019). National offices increase audit firms' – particularly Big 4 audit firms' – audit quality through knowledge sharing and internal monitoring (Chen and Choudhary 2020), and in response to external inspections, national offices is involved throughout the inspection process to prepare auditors (Westermann et al. 2018; Malsch and Couchoux 2020). Given the amount of resources devoted by audit regulators to inspecting auditors and by national offices to supporting auditors to make sound judgment, it is imperative to understand whether such efforts achieve their goal of improving audit quality. I study the effect of this combination of efforts in the context of auditor proposed accounting adjustments.

Accounting adjustments refer to "a proposed correction of the financial statements that, in the auditor's judgment, may not have been detected except through the auditing procedures performed" (para .09, AU 380, Communication with Audit Committees). After auditors conduct tests and gather audit evidence, typically the audit partner presents auditor-uncovered financial reporting misstatements to client management. The audit partner and the client management then collectively decide to make (record) or waive (not record) the proposed adjustments (or some

thereof) through negotiations. Such negotiations between audit partner and client management over proposed audit adjustments is widespread, even in the post-SOX environment (Antle and Nalebuff 1991; Gibbins et al. 2001; Gibbins et al. 2005; Sanchez et al. 2007). The outcome of these negotiations is recorded adjustments that change financial statement amounts from the amounts presented to the auditor by client management to the amounts ultimately agreed by both the auditor and the management. As such, auditor proposed adjustments and the negotiations between audit partner and client management to resolve those adjustments are among the final steps in the financial reporting process and a key determinant of audit quality and financial reporting quality (Choudhary et al. 2018). In other words, negotiations over auditor proposed accounting adjustments are directly linked to audit regulator's concern of audit quality.

Researchers have recognized that contextual features outside direct control of negotiating parties play an important role throughout the negotiation process (Gibbins et al. 2001; Salterio 2012). Such contextual features include accounting standards (Ng and Tan 2003), negotiators' competence (Iyer and Rama 2004; Gibbins et al. 2010; Ng and Shankar 2010), and the relationship between client management and auditor (Bame-Aldred and Kida 2007; Gibbins et al. 2010; Wang and Tuttle 2009; Dodgson et al. 2020).<sup>2</sup> Despite the continued trend towards more consultations with national office throughout audit engagements (Deloitte 2019; EY 2019), it remains unclear how the approach in which national office handles consultations affects audit partners' negotiation behaviour. In this paper, I contrast between two distinct approaches national offices can take to consultations: prescriptive or collaborative. Under a prescriptive approach, national offices have an "overwhelming, overriding concern" with not being found

---

<sup>2</sup> Note that those are the contextual features that audit partners rank as significantly more important (Gibbins et al. 2001; Gibbins et al. 2005), or "top accounting contextual features". Less important features have also been studied but for brevity those studies are not listed here.

deficient in PCAOB inspections; under a collaborative approach, national offices view consultations as “a sign of strength to get the right answers” within constraints of audit standards as opposed to a way to avoid being caught deficient by regulators (Aghazadeh et al. 2020). The distinction is particularly relevant in the recent years as national offices appear to move from the prescriptive approach towards a collaborative approach (Aghazadeh et al. 2020), but the effect of such a change in approach remains unclear.<sup>3</sup> To understand and predict the effect of national office’s prescriptive (collaborative) approach towards consultation on audit partner’s judgment, I draw on regulatory focus theory.

### **Regulatory Focus Theory and Hypotheses Development**

Regulatory focus represents the motivational state under which an individual guides her goal-directed activities (Freitas and Higgins 2002; Cesario et al. 2004; Pham and Avnet 2009).<sup>4,5</sup> Regulatory focus theory is concerned with how goal is perceived and why specific goal-pursuit strategies are adopted as a result of that perception (Higgins 1997; Higgins 1998; Brockner et al. 2004).<sup>6</sup> In other words, regulatory focus theory is concerned with “how a person plays the game” as opposed to “whether a person wins or loses” (Kruglanski 2006).

Regulatory focus theory distinguishes between promotion focus and prevention focus. Promotion focus originates from growth and nurturance needs, and is associated with a

---

<sup>3</sup> Gold et al. (2012) manipulate whether consultation requirement is strict (mandatory and binding) versus lenient (advisory and non-binding). While a prescriptive (collaborative) national office may appear to be strict (lenient), the key in my construct is whether the national office focuses on avoiding being caught deficient (reaching the best solution) while staying in the constraint of audit standards, and thus is different from Gold et al. (2012).

<sup>4</sup> Regulation means “modulation of thought, affect, behaviour, or attention via deliberate or automated use of specific mechanisms and supportive metaskills” (Karoly 1993). An individual’s self-regulation encompasses the processes and motivations involved in regulating affect, cognition, and behaviour in relation to goals and outcomes, whether desired and undesired (Karoly 1993; Carver and Scheier 1998; Johnson et al. 2006; Higgins and Pittman 2008).

<sup>5</sup> Psychology literature refers to “regulatory focus”, “regulatory orientation”, “regulatory systems” without discrimination. For consistency, this study uses “regulatory focus” only. Other psychological states that have been studied by auditing researchers include mood (Griffith et al. 2018) and mindset (Griffith et al. 2015).

<sup>6</sup> Note that regulatory focus theory takes as given that people seek pleasure and avoid pain as goals (Higgins 1997b). It does not focus on value or expectancy of the goal itself (Feather 1982) or the outcome of goal pursuit.

sensitivity to achievement of ideals, hopes, aspirations, and advancement to a better state (Crowe and Higgins 1997). Prevention focus originates from protection and security needs, and is associated with a sensitivity to avoiding failure to fulfill duties, safeties, responsibilities, and maintaining against falling to a worse state (Higgins 1997; Higgins and Cornwell 2016).<sup>7</sup> A given goal can be perceived differently depending on which regulatory focus is activated for an individual. Individuals with a promotion (prevention) focus perceive their goal as expanding and approaching an achievement (contracting and avoiding failure) (Idson et al. 2004). As motivational states, promotion focus and prevention focus coexist in every person and are independent of each other (Pham and Avnet 2009; Higgins and Cornwell 2016). Neurological studies using fMRI also support the existence of two distinct systems regulating avoidance of punishment versus achievement of rewards (Cunningham et al. 2005; Keller and Bless 2006; Eddington et al. 2007; Touryan et al. 2007; Packer and Cunningham 2009).

Regulatory focus can be both chronic and situationally activated by contextual factors such as leadership approach (Crowe and Higgins 1997). Regulatory focus trickles down from leadership through the use of language and symbols (Brockner and Higgins 2001; Johnson et al. 2017), and employees' levels of regulatory focus change when leadership approach changes (Wallace and Chen 2006). For instance, prevention focus increases when leaders emphasize not violating safety regulations, whereas promotion focus increases when leaders "emphasize achievements and reaching for higher goals" (Wallace et al. 2009), focus on ideals (Kark and Van Dijk 2007), and frame the situation in terms of growth and development (Kark and Van Dijk

---

<sup>7</sup> Growth and nurturance as well as protection and security are two fundamentally different survival needs. Maslow (1955) distinguished "growth" needs from "deficit" or safety requirements. The importance of both what one would hope to be and what one ought to be are well noted by other researchers (Rogers 1960; Bowlby 1969; Bowlby 1973).

2007).<sup>8</sup> In the auditing context, a prescriptive approach towards consultations is concerned with ensuring an audit judgment would not be caught as deficient by audit regulators whereas a collaborative approach emphasizes getting to the best answer for all parties involved, within the constraint of accounting and auditing standards (Aghazadeh et al. 2020). Based on this descriptive evidence, a prescriptive approach towards national office consultations is likely to induce prevention focus in audit partners, whereas a collaborative one is likely to induce promotion focus.

Given motivational attributes have the most direct and powerful influence on behaviour (Barrick et al. 2002; Lanaj et al. 2012), auditor's regulatory focus as a motivational characteristic could have direct impact in their auditing behaviour through different goal pursuit strategies undertaken by promotion- and prevention-focused individuals (Scholer and Higgins 2008). That is, promotion-focus and prevention-focused individuals exhibit different goal pursuit behaviours. Promotion focused individuals perceive their goal as aspirations and ideals to approach – an alternative state. As a result, promotion focused individuals pursue goals by relying on strategies that encourage seizing opportunities to approach that ideal alternative state (Higgins et al. 1994; Crowe and Higgins 1997). In contrast, prevention focused individuals perceive their goals as failures to avoid. They pursue goals by relying on strategies that emphasize avoiding falling below a threshold and minimizing error of commission (Crowe and Higgins 1997) and thus favours the status quo rather than an alternative state.

---

<sup>8</sup> This type of framing is consistent with transformational leadership (Bass 1999). Indeed, researchers have linked transformational leadership with followers' promotion focus and transactional leadership with followers' prevention focus (Kark and Van Dijk 2007; Neubert et al. 2008; De Cremer et al. 2009; Lanaj et al. 2012; Johnson et al. 2017). However, given my hypotheses remain unchanged whether such behaviour is termed "transformational leadership", I do not introduce new constructs to keep parsimony of the paper.

Research has found that prevention focused negotiators are more committed to their negotiation goal because of their fear of falling below a threshold and thus losing the status quo (Molden and Hui 2011). In contrast, promotion focused individuals are less committed to their goals, because they are more concerned with whether an alternative ideal state is achieved (Molden and Hui 2011). Promotion and prevention focused individuals' different goal pursuit strategies also extend to negotiation strategy choice. Negotiators may choose to adopt integrative negotiation strategies (through which negotiators jointly solve problems, enlarge the pie, or find trade-offs for win-win solutions) or distributive negotiation strategies (through which negotiators divide a fixed pie that results in one party or neither party wins) at the onset of a negotiation (Bazerman and Moore 2012). Given promotion focused negotiators' concern with an alternative state, they are more likely to use integrative negotiation strategies that "create values" and create an alternative state, such as expand the agenda or problem solve. In contrast, prevention focused negotiators are concerned with not falling below a threshold. Given their focus on the status quo, they are less likely to use integrative negotiation strategies, and are more likely to use distributive strategies that focus on how the current pie is divided (Trötschel et al. 2013).

Thus, because a national office that takes a collaborative (prescriptive) approach to consultation activates promotion (prevention) focus in audit partners, I expect audit partners working with a collaborative (prescriptive) national office are less (more) committed to their goal at the onset of the negotiation, and are more (less) likely to choose integrative negotiation strategies such as problem solve and expand the agenda.

My hypotheses are not without tension. While extant literature documents how regulatory focus trickles down from leader to employees (Johnson et al. 2017), auditors who propose accounting adjustments and resolve differences with client management are usually engagement

partners. Their relationship with national office is not exactly that of leader-followers. Thus, it remains to be tested whether regulatory focus' trickle-down effect applies to a less hierarchical context. My first set of hypotheses is as follows.

**H1a:** Compared to those working with a prescriptive national office, audit partners working with a collaborative national office are less committed to their negotiation goals.

**H1b:** Compared to those working with a prescriptive national office, audit partners working with a collaborative national office are more likely to use integrative negotiation strategies (such as expand the agenda or problem solve).

Given one important role national offices play is to prepare for audit inspections, I also examine whether characteristics of audit inspections moderate the effect of national office approach on audit partner's judgment. It is important to examine the effect of such regulatory features on auditor-client management negotiations because they are ranked as a significantly important contextual factor by auditors, yet their effect is not understood (Gibbins et al. 2001; Salterio 2012).

Communication from audit regulators to auditors, including inspection reports, provides feedback to auditors under inspection. Such feedback is influenced by the audit regulatory environment, which can be more antagonistic or less antagonistic. For example, PCAOB's inspection reports are known to be "penalties oriented" (Peecher et al. 2013), and auditors perceive "everything in the inspection report" as "an audit failure" (Johnson et al. 2018). Indeed, almost all PCAOB reports start inspection results with how auditors failed their task (for example, see Appendix 2, Panel A). Psychologists find that such antagonistic feedback – one that anchors on presence and absence of failure – activates prevention focus (Roney et al. 1995; Idson and Higgins 2000; Van Dijk and Kluger 2004; Van Dijk and Kluger 2011). In Roney et al.

(1995), the same negative outcome activates a promotion focus (prevention focus) if the feedback is anchored on opportunity of improvement (anchored on failure).<sup>9</sup>

Given the current audit regulatory environment, particularly that in the U.S., is characterized by “antagonistic” inspections (Dowling et al. 2018; Westermann et al. 2018), feedback anchored on presence and absence of failure should lead to prevention focus in auditors. Thus, a failures-anchored feedback should induce congruent (incongruent) regulatory focus if national office’s approach towards consultation is prescriptive (collaborative). Conversely, if inspection feedback is anchored on opportunities of improvement, then such inspection feedback should lead to promotion focus, and thus induce congruent (incongruent) regulatory focus if national office approach is collaborative (prescriptive).<sup>10</sup> Research has found that alignment of regulatory focus, or regulatory fit, leads to improvements in task performance, such as greater persistence and higher endurance (Förster et al. 1998; Hong and Lee 2008) and willingness to behave in ways that improve measured outcomes (Higgins et al. 2003; Avnet and Higgins 2006). However, psychology and consumer behaviour literature have largely focused on alignment between the goal frame and the goal pursuit strategy manipulated. It is unclear whether findings from regulatory fit extends to the alignment of two contextual cues that both induce regulatory focus. If regulatory fit applies to alignment of two contextual cues, then I should expect that audit partners are more committed to their goal, and more willing to use

---

<sup>9</sup> Levin et al.'s (1998) discussion on “goal framing” touches upon a similar idea that “linguistic variation [in goal framing] may also influence the strength of goal framing effects; that is, the alternative terms are not perceptually equal... while *promoting the same end result*” (173 – 174, emphasis original). Their paper’s focus on differences among three types of framing is beyond the scope of this paper.

<sup>10</sup> I acknowledge that the current U.S. audit regulatory environment makes it unrealistic to have inspection feedback anchored on opportunities of improvement. However, outside U.S., feedback from audit inspection takes different styles (Malsch and Couchoux 2020), and even within U.S., researchers have called for new ways to reframe auditors’ incentives different from current exclusively punitive ones to improve audit quality over the long term (Peecher et al. 2013). Both lend plausibility to my manipulation, and my experimental design overcomes the external validity issue by using a Canadian setting. See Section III for details.

distributive strategies to claim a share of the pie (as opposed to only using integrative strategies that expand the pie) when national office approach and inspection feedback orientation induce matching regulatory focus than when they induce difference ones, because regulatory fit leads people to “feel right” and persist in their goal pursuit behaviour.

In my second set of hypotheses, I focus on the effect of regulatory focus alignment conditional on national office having a collaborative approach towards consultations. I do so for two reasons. First, post SOX, national offices appear to gravitate towards a collaborative approach (Aghazadeh et al. 2020), thus, examining the collaborative condition is more relevant. Second, given my first set of hypotheses points to potential downside of a collaborative national office, that is, a collaborative approach could lead to less committed audit partners who look for win-win with client, I explore whether aligning regulatory focus through less antagonistic feedback – inspection feedback anchored on opportunities of improvement – could mitigate the negative consequences. However, my hypotheses are not without tension, as the extant literature provides little on point guidance on how alignment between two regulatory-focus-inducing contextual cues affect judgment. I state my second set of hypotheses as follows.

**H2a:** For audit partners working with a collaborative national office, changing regulator’s inspection feedback anchor from failures to opportunities of improvement leads to greater commitment to audit partners’ negotiation goals.

**H2b:** For audit partners working with a collaborative national office, changing regulator’s inspection feedback anchor from failures to opportunities of improvement reduces audit partners’ likelihood to use integrative negotiation strategies (such as expand the agenda or problem solve).

### **III. EXPERIMENTAL DESIGN**

I test my hypotheses in a  $2 \times 2$  experiment in which I manipulate efforts to improve audit quality within audit firm (national office’s *prescriptive* vs. *collaborative* approach towards

consultations) and outside firm (inspection feedback anchored on *failure* vs. opportunities of improvement [*improvement* hereafter]) between subjects.

### **Task**

Participants took the role of an engagement partner preparing to propose accounting adjustments to client management. Participant read the case material and provided their negotiation-related judgments. The case, adapted from Gibbins et al. (2010), provides background information about the audit firm and the client. The case includes information about current year audit work, where the audit team believe net income is overstated by a material amount due to both clear-cut errors and differences in estimates. I hold constant key contextual features that prior literature found to influence negotiations between auditor and client management, including characteristic of the client board (including its audit committee) (Ng and Tan 2003), auditor tenure (Wang and Tuttle 2009; Dodgson et al. 2017), the review partner and the audit team (Bobek et al. 2012), time pressure (Tan and Trotman 2010; Bennett et al. 2015), and relationship between the client and the auditor (Gibbins et al. 2010; Dodgson et al. 2020). The adapted experiment instrument was reviewed by a Big 4 audit partner and a former senior manager who worked at national office of a Big 4 firm. They confirmed the case's understandability, realism, and provided comments that are incorporated into my instrument.

After reading the case, participants provided their pre-negotiation judgment, including how likely they are to use distributive and integrative strategies to resolve the accounting differences. Next, participants answered additional questions, including their commitment to their goal of reducing client's net income. Lastly, participants completed post-experimental questionnaire and demographic questions. I pilot tested my instrument on 81 upper year

undergraduate students with audit experience. Results show my manipulations generated reactivity and in expected directions.

## **Independent Variables**

### ***National Office Approach***

I manipulate approach to national office consultations as prescriptive or collaborative. Based on prior literature (Salterio and Denham 1997; Aghazadeh et al. 2020) and conversation with practitioners, I describe a prescriptive national office as one that is concerned with not being caught deficient by audit regulator, being defensive with their decisions, and adopts an authoritative and formal process. I describe a collaborative national office as one that is concerned with supporting the auditor to come up with a well-supported conclusion within constraints of audit standards, adopts a process that works alongside with the auditor and leaves room for informal check-ins. See Appendix 1, Panel A for exact wording of the manipulations.

### ***Inspection Feedback Anchor***

I manipulate regulator's inspection feedback as anchored on failure or anchored on opportunities of improvement. In *failure* condition, participants receive feedback from audit regulator that her audit team failed to critically evaluate reasonableness of an issuer's revenue recognition prior to reaching its conclusion. Further, the team failed to consider contradicting evidence and failed to evaluate whether the client could satisfy its assumptions. In *improvement* condition, participants receive feedback from the same regulator who indicates that her audit team did not achieve high quality in critically evaluating reasonableness of an issuer's revenue recognition. Further, the team did not achieve high quality in considering contradicting evidence and did not achieve high quality in evaluating whether the client could satisfy its assumptions. See Appendix 1, Panel B for exact wording of the manipulations across each condition.

The choice of audit regulator who provides either failure- or improvement-anchored feedback in the case is intentional. The U.S. audit regulator, PCAOB, is known for the antagonistic manner it interacts with auditors under inspection (Dowling et al. 2018; Westermann et al. 2018). Given it is highly unlikely that the PCAOB would provide feedback in a non-antagonistic way, using PCAOB in my manipulation could potentially sabotage its effectiveness. On the other hand, the Canadian audit regulator, Canadian Public Accounting Board (CPAB) is perceived to be different from the PCAOB (Malsch and Couchoux 2020; Peecher et al. 2013) such that both failure- and improvement-anchored feedback styles could remain plausible. Furthermore, I expect most of my participants to have direct experience with CPAB (as opposed to PCAOB) inspections, thus, using CPAB as the audit regulator in the experiment mitigates the concern that the results are driven by (un)familiarity of the style in which inspection feedback is delivered.<sup>11</sup>

To explore potential differences between CPAB and PCAOB, I collect data in two additional cells. In those two cells, I manipulate national office as prescriptive and collaborative, as described above. Inspection feedback, however, comes from joint PCAOB-CPAB inspection (as opposed to CPAB inspection) and is anchored on failure, because this is the style that the PCAOB is known for.<sup>12</sup> Keeping only failure-anchor also ensures I use audit partners and senior managers most efficiently. Thus, the full experiment uses a 2 (national office approach: prescriptive vs. collaborative) × 3 (inspection feedback: CPAB anchored on failure vs. CPAB

---

<sup>11</sup> However, Canadian auditors collectively experience both CPAB inspections and PCAOB inspections (in the form of joint CPAB-PCAOB inspections) because those Canadian auditors with clients cross listed in the U.S. are subject to inspections jointly conducted by PCAOB and CPAB.

<sup>12</sup> I refer to PCAOB-CPAB joint inspections instead of PCAOB inspections in the instrument because PCAOB's inspections of Canadian audit firms are done in conjunction with CPAB. I use PCAOB and joint PCAOB-CPAB inspection interchangeably in my subsequent discussion for brevity.

anchored on improvement vs. PCAOB anchored on failure) factorial design, although my main focus is on the fully crossed 4 cells described earlier.

### **Dependent Variables**

Consistent with Gibbins et al. (2010) from which I draw my instrument, I measure two primary dependent variables: commitment to negotiation goals and intended negotiation strategy. Auditors responded to the statement “You feel strongly that you have to achieve a resolution that will result in a substantial reduction in JEL’s unaudited net income” on an 11-point Likert scale (-5 “completely disagree” to 5 “completely agree”). I use this dependent measure, which has been validated in prior literature (Locke and Latham 1990; Gibbins et al. 2010), to test Hypotheses 1a and 2a. To control for the possibility that participants set different goals due to my manipulations, I also ask participants what their negotiation goal is (“What amount of accounting adjustments, if any, would be your goal in your discussion with JEL’s management to resolve the differences between your audit team and the client?”), to which participants provided a numerical answer.

To measure auditors’ intended negotiation strategy use, I use validated measures from Gibbins et al. (2010) that adapted from an inventory of tactics in Rahim (1983) to the auditor-client management negotiation setting. Auditors indicate on an 8-point scale ranging from 0 (“very unlikely to use”) to 7 (“very likely to use”) how likely they are to use each of the 21 tactics that are either integrative (“Expand the agenda” and “Problem solve” strategies that seek win-win) or distributive (Contend, Concede, or Compromise strategies that result in one party wins or neither party wins). The order of the negotiation tactics is randomized for participants. I discuss the validity of the measures in Results section below.

## Participants

A total of 131 audit partners and senior managers from six international public accounting firms (including all Big 4 firms and two medium-sized audit firms) accessed the online experiment.<sup>13</sup> Of those participants, 98 auditors (76 from Big 4, 9 from medium international firms, 1 other, 12 unidentified) proceeded beyond the case material.<sup>14</sup> The median time spent on the experiment is 26 minutes. On average, participants had 19 years of experience, with 90% of participants had at least 10 years of experience and 50% had at least 20 years, and all of them held audit partner or senior manager position. Thus, participants are appropriate for the experiment task, resolving accounting adjustments with client management (Gibbins et al. 2001). Thirty percent of participants were female. Most participants indicated experience with Canadian public companies (80%) and U.S.-listed public companies (61%). As expected, most of my participants had experienced CPAB inspections (79%), with less than half had experience with joint PCAOB-CPAB inspections (42%). This validates my choice of using CPAB as the audit regulator in the case. I include firm type (Big 4, medium size, other) as a covariate in my analyses consistent with findings from Gibbins et al. (2001) and archival literature that finds differential effects of national office on Big 4 versus non-Big 4 firms (Chen and Choudhary 2020). None of the other demographic factors differs across conditions and hence is not discussed further. Table 1 lists participant exclusion criteria, their distribution across conditions, inspection experience, and demographic information in Panels A, B, C, and D, respectively.

[Insert Table 1 here]

---

<sup>13</sup> The experiment received ethics approval from the university.

<sup>14</sup> The number of participants included in analyses differs due to missing responses to individual dependent measures.

Participants indicated that in their practice, they have involved their national office and thought about audit regulators as they proposed accounting adjustments and resolved differences with clients (both significantly greater than “half of the time”,  $p$ -value = 0.000). Participants also rated the case as realistic (7.57 on a scale of 0 to 10 for the statement “The case is realistic”,  $p$ -value = 0.000) and relatively easy (8.64 on a scale of 0 to 10 for the statement “The case is easy to understand”,  $p$ -value = 0.000). Audit partners and senior managers did not perceive differences across cells in other non-manipulated aspects of the audit environment that are mentioned in the experiment instrument, including how tight the timelines are to resolve the issues with the client management, whether a range of acceptable net income number exists, and financial reporting aggressiveness of the client (all  $p$ 's > 0.50).

#### **IV. RESULTS**

##### **Comprehension Check**

Participants recalled the style of communication with national office in the case. Participants in the prescriptive condition recalled the style as significantly more formal than participants in the collaborative condition (9.22 vs. 7.69,  $p = 0.001$ ).<sup>15</sup> Participants also recalled who conducted audit inspection in the case. Ten participants (10%) recalled a different regulator than what is specified in the case. I use responses from all participants in my analyses as inclusion does not lead to qualitatively different responses unless otherwise noted.

##### **Manipulation Check**

Based on regulatory focus theory, I theorize that inspection feedback anchored on opportunities of improvement activates a promotion focus whereas feedback anchored on failure activates a prevention focus. Consistent with promotion-focused (prevention-focused)

---

<sup>15</sup> Unless otherwise noted, I use one-tailed t-test for directional predictions.

negotiators being more concerned with what they want to achieve (what they do not want to fall below), untabulated t-test shows that participants receiving improvement-anchored feedback rated their negotiation goal as marginally more important than those receiving failure-anchored feedback (6.23 vs. 5.89,  $p = 0.092$ ), suggesting that improvement-anchored feedback activates a stronger promotion focus than failure-anchored feedback. My manipulation checks provide some evidence of regulatory focus manipulation, consistent with prior studies that find regulatory focus may be activated unconsciously, and that people are not typically aware of their focus (Bargh and Chartrand 1999; Peecher et al. 2019).

### **Negotiation Strategy Measures**

I first replicate findings in Gibbins et al. (2010) that the 21 validated measures load on to predicted constructs. Based on Gibbins et al. (2010), I expect *ex ante* that tactics 1 to 5 represent the latent variable “Expand the Agenda” strategy (integrative); tactics 6 to 10 represent the latent variable “Concede” strategy (distributive); tactics 11 to 13 represent the latent variable “Compromise” strategy (distributive); tactics 14 to 17 represent the latent variable “Contend” strategy (distributive); tactics 18 to 21 represent the latent variable “Problem Solve” strategy (integrative). Results from principal component factor analysis and confirmatory factor analysis generally replicate their results (c.f., Gibbins et al 2010, Table 4), which I report in Table 2 and discuss below.

Principal component factor analysis using participants’ responses to the 21 tactics (“Please rate how likely you would take each of the following approaches in this specific situation in the case.” on a scale from 0 (very unlikely to use) to 7 (very likely to use), subsequently recoded to 1 to 8) confirms, as expected, existence of five factors with eigen values greater than 1.0. Together, these five factors account for 59% of the variances. Using a factor

loading cut-off of 0.5 and varimax rotation, negotiation tactics 1, 2, and 4 load onto factor 1 with a Cronbach's alpha of 0.83; negotiation tactics 6, 7, and 8 load onto factor 2 with a Cronbach's alpha of 0.80; negotiation tactics 11, 12, and 13 load onto to factor 3 with a Cronbach's alpha of 0.64; negotiation tactics 15, 16, and 17 load onto factor 4 with a Cronbach's alpha of 0.49; negotiation tactics 18, 19, and 21 load onto factor 5 with a Cronbach's alpha of 0.72.<sup>16</sup> In other words, negotiation tactics load onto factor 1, 2, and 5 with Cronbach's alpha of 0.72 to 0.83, indicating good fit for those three factors (Nunnally 1978). Table 2 lists the factor that each tactic loads onto. Comparing principal factor analysis results with my expectation, factor 1 corresponds to latent variable "Expand the agenda" strategy, factor 2 corresponds to latent variable "Concede" strategy; factor 3 corresponds to "Compromise" strategy with low Cronbach's alpha; factor 4 corresponds to "Contend" strategy with low Cronbach's alpha; factor 5 corresponds to "Problem Solve" strategy.

To validate these underlying latent constructs, I use confirmatory factor analyses on the factors that emerge. A three-factor model using factor 1 ("Expand the Agenda"), factor 2 ("Concede") and factor 5 ("Problem Solve") shows the best fit (goodness of fit statistics:  $\chi^2$  (24) = 18.33,  $p = 0.787$ , CFI = 1.000, RMSEA = 0.000), and all tactics load significantly to their corresponding latent variables ( $p = 0.000$ ).<sup>17</sup> Based on the exploratory factor analysis and confirmatory factor analysis, I conclude that Concede, Expand the Agenda, and Problem Solve strategies have tactics load onto them significantly and according to predictions: tactics 6, 7, and 8 load onto Concede; tactics 1, 2 and 4 load onto Expand the Agenda; tactics 18, 19, 21 load onto

---

<sup>16</sup> I obtain the same factors with quartimax rotation and oblique rotation. The two strongest factors (factors 1, composed of tactic 1, 2, and 4; factor 2, composed of tactic 6, 7, and 8) are the same as varimax rotation.

<sup>17</sup> In comparison, a five-factor model fails to converge. Dropping the weakest factor, a four-factor model using factor 1 ("Expand the agenda"), factor 2 ("Concede"), factor 3 ("Compromise"), and factor 5 ("Problem Solve") shows poor fit ( $\chi^2$  (48) = 71.90,  $p = 0.014$ , RMSEA = 0.073, CFI = 0.936). A three-factor model using factor 1, 2 and 3 shows slightly worse fit ( $\chi^2$  (24) = 26.98,  $p = 0.305$ , RMSEA = 0.036, CFI = 0.989) than the model using factors 1, 2, and 5.

Problem Solve. To test my hypotheses on integrative negotiation strategies, I use the average of tactics 1, 2, 4 to form one composite measure for Expand the Agenda strategy, and the average of tactics 18, 19, 21 to form one composite measure for Problem Solve. For distributive negotiation strategies, I use the average of tactics 6, 7, 8 to form one composite measure for Concede. I use the composite measures to run  $2 \times 2$  ANOVA, where each latent negotiation strategy variable is the main dependent variable.<sup>18</sup>

[Insert Table 2 here]

### **Preliminary Analysis**

Untabulated ANOVA shows that, across all six cells (four main experiment conditions plus two conditions where failure-anchored feedback comes from joint PCAOB-CPAB inspection), there is a marginally significant ( $p = 0.072$ ) main effect of inspection on audit partners' commitment to their goal of reducing client's net income, a marginally significant ( $p = 0.066$ ) main effect of national office and an interaction effect of national office and inspection that approaches significance on audit partners' use of Expanding the Agenda strategy ( $p = 0.106$ ), and a marginally significant ( $p = 0.094$ ) main effect of inspection on audit partners' use of Concede strategy. I discuss my tests of hypotheses on the four main conditions, followed by analyses on the two additional conditions where inspection is delivered jointly by the PCAOB and CPAB.

### **Tests of Hypotheses**

I first test whether audit partners set *different* goals in response to my manipulations.

Untabulated simple t-test shows that participants in the prescriptive national office conditions set

---

<sup>18</sup> I also run MANOVA using the underlying tactics that form the latent variables Expand the Agenda (tactics 1, 2, 4), Concede (tactics 6, 7, 8), and Problem Solve (tactics 18, 19, 21). Results are consistent with ANOVA unless otherwise noted.

significantly higher goal than those in the collaborative national office conditions (33.12 vs. 29.29,  $t = 2.13$ ,  $p = 0.019$ ). Partners' commitment to their negotiation goal is also correlated with the goals they set (significant at 0.1 level). As such, I control for negotiation goal in my subsequent analyses on audit partners' commitment to their goals. For completeness, Table 3 includes descriptive statistics and  $2 \times 2$  ANOVA using audit partner's goal as dependent variable.

[Insert Table 3 here]

Hypothesis 1a predicts that a collaborative national office approach reduces audit partners' commitment to their goal of reducing client's net income. Hypotheses 2a predicts that changing inspection feedback anchor from failure to opportunities of improvement increases commitment for audit partners working with a collaborative national office. Descriptive statistics (raw and adjusted means and standard deviations) are shown in Table 4, Panels A and B. I also include the conventional ANOVA and post hoc tests in Table 4, Panels C and D. Given my ordinal interaction prediction, contrast coding is the most appropriate test. In accordance with the hypothesized interaction, contrast weight of -3 in the Collaborative National Office/Failure-anchored Inspection feedback and +1 for the other three conditions are appropriate (Buckless and Ravenscroft 1990; Guggenmos et al. 2018). As shown in Table 4, Panel E, the planned custom contrast is highly significant ( $p = 0.015$ ), with insignificant residual between-cell variance ( $p = 0.784$ ) providing support for H1a and H2a. In other words, audit partners working with a collaborative national office are less committed to reducing client's net income, but inspection feedback anchored on opportunities of improvement (rather than failure) mitigates the negative consequences and increases audit partners' commitment to reducing client's net income. Figure 1 illustrates the results for H1a and H2a.

Follow-up tests provide additional support for my hypotheses. Untabulated simple t-test shows that a prescriptive national office approach results in significantly higher commitment in audit partners than a collaborative one (9.62 vs. 8.71,  $p = 0.040$ ). As shown in Table 4, Panel C, two-way ANCOVA shows a marginally significant main effect of national office approach ( $p = 0.085$ ) and a marginally significant main effect of inspection feedback orientation ( $p = 0.079$ ).<sup>19</sup> Post hoc tests (Table 4, Panel D) show that, when inspection feedback is anchored on failure, a collaborative national office leads audit partners to be significantly less committed to their goal of reducing client's net income than a prescriptive national office ( $F_{1,54} = 4.88, p = 0.032$ ).<sup>20</sup> Post hoc analysis also shows that, conditional on a collaborative national office approach, audit partners who receive improvement-anchored feedback are significantly more committed to reducing client's net income than partners who receive failure-anchored feedback (9.29 vs. 7.89,  $F_{1,54} = 5.25, p = 0.027$ ), supporting hypothesis H2a.<sup>21</sup> Overall (collapsing across national office approach), improvement-anchored feedback result in marginally higher goal commitment compared to failure-anchored feedback among audit partners (9.52 vs. 8.83,  $p = 0.094$ ).

My findings suggest that audit firms' move towards a more collaborative approach of national office consultations could lead to audit partners being less committed to reducing client's aggressive net income. However, the negative effect of a collaborative national office is mitigated when the audit regulatory environment is less antagonistic (i.e., when inspection feedback anchor changes from failure to opportunities of improvement) even when the underlying issues discovered and reported during inspection are held constant.

---

<sup>19</sup> Dropping those who failed comprehension check results in a statistically significant main effect ( $p = 0.025$ ) of feedback orientation and a marginally significant interaction ( $p = 0.076$ ). Excluding controls (firm type and negotiation goal), national office remains significant ( $p = 0.047$ ) while feedback orientation approaches significance ( $p = 0.114$ ).

<sup>20</sup> Simple t-test shows a consistent significant difference with t value of 2.14 and  $p$  value of 0.022.

<sup>21</sup> Simple t-test shows a consistent significant difference with t value of 1.90 and  $p$  value of 0.036.

[Insert Table 4 and Figure 1 here]

Hypothesis H1b and H2b predict the effect of national office approach and inspection feedback on audit partners' negotiation strategy choice. Consistent with prior literature finding audit partners are inclined to use integrative strategies that seek "win-win" for both the client and the auditor than distributive strategies that seek to divide the pie so that one (or neither) party wins (Gibbins et al. 2010, Table 5), audit partners in my experiment are significantly more likely to use Problem Solve strategy than Concede strategy (6.45 vs. 3.91,  $p = 0.0000$ ). However, audit partners in my experiment are more likely to use Concede strategy than Expand the Agenda (3.91 vs. 2.70,  $p = 0.000$ ).

Focusing specifically on integrative negotiation strategies, Table 5, Panel A shows the descriptive statistics, while Panels B and C provide conventional ANOVA test and post hoc analysis for Expand the Agenda strategy. The results for contrast testing are shown in Table 5, Panel D. Using contrast weight of +3 in the Collaborative National Office/Failure-anchored Inspection feedback and -1 for the other three conditions (Buckless and Ravenscroft 1990; Guggenmos et al. 2018), I find the planned custom contrast is significant ( $p = 0.061$ ), with insignificant residual between-cell variance ( $p = 0.124$ ), providing support for my H1b and H2b.

Consistent with my hypothesis, audit partners in the collaborative national office conditions are significantly more likely to use integrative negotiation strategy (Expand the Agenda) than partners in prescriptive national office conditions (2.94 vs. 2.41,  $p = 0.049$ ). Two-way ANOVA shows a significant main effect of national office approach ( $p = 0.008$ ). Post hoc tests (Table 5, Panel C) show that, given failure-anchored inspection feedback, partners are more likely to prefer integrative negotiation strategy (Expand the Agenda) when they work with a collaborative national office than a prescriptive national office ( $F_{1,54} = 3.37$ ,  $p = 0.072$ ).

To the extent that researchers are concerned with how audit partners readily adopt integrative negotiation strategy that seek to “create value” or accomplish win-win with clients, my results suggests that a move towards a collaborative approach of national office consultations in an antagonistic audit regulatory environment could worsen the problem. The negative effect of a collaborative national office is not mitigated when the inspection feedback anchors on opportunities of improvement (as opposed to failure): given a collaborative national office approach, audit partners who receive improvement-anchored feedback are as likely to prefer integrative negotiation strategy (Expand the Agenda) as partners receiving failure-anchored inspection feedback ( $F_{1, 54} = 0.20, p = 0.654$ ), failing to support hypothesis H2b even though directionally, partners receiving improvement-anchored feedback appear to be less inclined to use integrative strategy (Expand the Agenda) than those receiving failure-anchored feedback. Thus, a collaborative national office leads audit partners to be on the outlook for win-win with the client, regardless of whether audit regulator’s inspection feedback stress opportunities of improvement or failure. Figure 2 illustrates the results for H1b and H2b.

[Insert Table 5 and Figure 2 here]

Descriptive statistics of audit partners’ use of Problem Solve negotiation strategy is shown in Table 6. While ANOVA and contrast testing (untabulated) do not show a significant effect when Problem Solve negotiation strategy is the dependent variable, both ANOVA and contrast testing show results broadly consistent with theory when I use the average of Expand the Agenda and Problem Solve to form a composite measure for integrative negotiation strategy (results untabulated). Specifically, ANOVA shows a marginally significant effect of national office ( $F_{1, 58} = 3.04, p = 0.087$ ). Using contrast weight of +3 in the Collaborative National Office/Failure-anchored Inspection feedback and -1 for the other three conditions (Buckless and

Ravenscroft 1990; Guggenmos et al. 2018), I find the planned custom contrast approaches significant ( $p = 0.107$ ), with insignificant residual between-cell variance ( $p = 0.308$ ).

[Insert Table 6 here]

I also analyze how likely participants are to use distributive negotiation strategies (specifically, Concede strategy). While untabulated ANOVA does not show a significant main or interaction effect, simple t-test shows that audit partners receiving failure-anchored feedback are directionally more likely to use Concede than partners receiving improvement-anchored inspection feedback (4.15 vs. 3.68,  $t = 1.14$ ,  $p = 0.130$ ). This would be consistent with the theoretical argument that failure-anchored (improvement-anchored) feedback activates prevention focus (promotion focus), and prevention focused negotiators are more likely to use distributive negotiation strategy than promotion focused negotiators.<sup>22</sup> Figure 3 illustrates the results.

[Insert Table 7 and Figure 3 here]

### **Supplemental Analysis**

In my supplemental analysis, I perform path analyses to provide additional evidence on the hypothesized relationship between national office approach / inspection feedback anchor, regulatory focus, and goal commitment / negotiation strategy choice. I then rule out plausible alternative hypotheses. Finally, I compare my main results to those of the two additional cells where the inspection is conducted by PCAOB and CPAB jointly to provide evidence on institutional effect of audit inspection independent of how inspection feedback is delivered.

---

<sup>22</sup> In particular, Trötschel et al. (2013) find that prevention focused negotiators are likely to use Concede strategy when they have low goals (but are less likely to concede if they have high goals). Given prior auditor-client negotiation literature finds that audit partners do not start negotiations with a high opening amount that they subsequently walk down (Gibbins et al. 2010), my findings are consistent with the interpretation that prevention focused audit partners in my experiment are more likely to use Concede strategy because audit partners' negotiation goals are low.

I use the Preacher and Hayes (2008) bootstrapping approach (PROCESS model 8 in SPSS) to test the indirect effect of national office approach and inspection feedback anchor on my dependent variables (commitment to negotiation goals and use of integrative negotiation strategy) via regulatory focus. In untabulated model where the dependent variable is audit partners' commitment to their negotiation goals, the conditional process analysis shows a significant model ( $p = 0.022$ ) and a significant path from national office approach and inspection feedback anchor to auditor's promotion focus ( $a_{11} = 0.51, p = 0.004$ ;  $a_{12} = 0.53, p = 0.027$ ;  $a_{13} = -0.06, p = 0.021$ ). In Figure 4, I show the moderated mediation model where the dependent variable is audit partners' use of integrative negotiation strategy (Expand the Agenda). The conditional process analysis yields a significant model ( $p = 0.026$ ) for. In addition to significant individual and interaction paths from national office approach and inspection feedback anchor to promotion focus, the path from audit partners' promotion focus to integrative negotiation strategy use is also significant ( $b_1 = -0.65, p = 0.004$ ).

[Insert Figure 4 here]

In Figure 5, I report additional path analyses. In the model specified (model significant at  $p = 0.000$ ), I find that using integrative negotiation strategy is negatively related to the amount of accounting adjustments audit partners propose, such that audit partners who are more likely to engage in Expand the Agenda strategy also propose lower accounting adjustments ( $p = 0.003$ ), and audit partners who are more likely to engage in Problem Solve strategy also propose lower accounting adjustments ( $p = 0.094$ ), in addition to a significant relationship between national office approach and the negotiation goal that partners would like to achieve ( $p = 0.027$ ).

Furthermore, I rule out that my results are driven by other competing hypotheses. First, I rule out that audit partners feel less accountable when inspection feedback anchors on

opportunities of improvement rather than failure. Participants' response to the question "You feel highly accountable to the external inspector" does not differ by condition (all  $p$ 's greater than 0.5). I also rule out that the negotiation judgment is driven by risk attitude, as participants' self-assessed risk attitude does not differ by condition (all  $p$ 's greater than 0.5).

I also analyze the additional conditions, where joint PCAOB-CPAB inspection delivers failure-anchored feedback but national office varies between participants as having either a collaborative or a prescriptive approach to consultations. I group those two additional cells with the two experimental conditions where the same failure-anchored feedback is delivered by CPAB, thus forming a 2 (inspector: joint PCAOB-CPAB vs. CPAB)  $\times$  2 (national office approach: prescriptive vs. collaborative) between subject design. I use this new 2  $\times$  2 design to tease out the effect of unobservable institutional difference while holding constant everything else that is difficult to control for outside of experimental method, such as the content of inspection report. I find a significant main effect of inspector on audit partners' commitment to their negotiation goals (untabulated ANOVA:  $F_{1, 56} = 3.83, p = 0.056$ ) such that partners receiving feedback from joint PCAOB-CPAB inspection are more committed than those receiving the exact same feedback from CPAB inspection (8.83 vs. 9.73,  $t = 1.69, p = 0.049$ ). However, the difference in commitment is entirely driven by collaborative national office condition (7.89 vs. 9.76,  $t = 2.61, p = 0.008$ ). I also find a marginally significant interaction effect of inspector  $\times$  national office approach on audit partners' likelihood to use integrative negotiation strategy (Expand the Agenda) (untabulated ANOVA:  $F_{1, 63} = 2.90, p = 0.094$ ). Specifically, audit partners under joint PCAOB-CPAB inspections are marginally less likely to use Expand the Agenda strategy than partners under CPAB inspection when national office is collaborative (3.36 vs. 2.46,  $t = 1.62, p = 0.058$ ).

Audit partners receiving feedback from joint inspections are also less likely to use Problem Solve strategy than partners receiving the same feedback from CPAB inspection (6.71 vs. 6.24,  $t = 1.41$ ,  $p = 0.082$ ). The differential likelihood to use Problem Solve strategy is concentrated in the prescriptive national office condition (6.80 vs. 5.86,  $t = 1.88$ ,  $p = 0.035$ ). Furthermore, I find a significant main effect of inspector on audit partners' likelihood to use Concede negotiation strategy (untabulated ANOVA:  $F_{1,63} = 5.68$ ,  $p = 0.020$ ). Specifically, audit partners receiving feedback from joint inspections are less likely to use Concede strategy than partners receiving the same feedback from CPAB inspection (4.15 vs. 3.33,  $t = 2.34$ ,  $p = 0.012$ ). The differential likelihood to use Concede strategy is concentrated in prescriptive national office conditions (4.29 vs. 3.06,  $t = 2.90$ ,  $p = 0.004$ ).

These results indicate the existence of unobservable institutional differences beyond content, tone, or anchor of the inspection feedback per se, and validate my experimental design choice to specify the inspector and thus control for such unobservable institutional differences. These results also suggest that, despite audit professionals' claim that PCAOB inspections have gone too far in terms of penalizing auditors, partners are less likely to concede or solve problems together with clients when they face PCAOB inspections than when they face CPAB inspections, particularly when national office is prescriptive. With a collaborative national office, there is no difference in partners' likelihood to use Concede or Problem Solve strategy, but partners are more committed and less likely to resort to Expand the Agenda strategy. Thus, while a collaborative national office may be detrimental to auditors under CPAB inspections, they might be beneficial to auditors under PCAOB or joint PCAOB-CPAB inspections.

Concentrating on the  $1 \times 2$  conditions, I find that, given PCAOB inspections, audit partners working with a collaborative national office are less likely to use Concede strategy than

those working with a prescriptive national office (3.59 vs. 3.06,  $t = 1.30$ ,  $p = 0.10$ ), and more likely to use Problem Solve strategy than those working with prescriptive national office (5.86 vs. 6.59,  $t = 1.62$ ,  $p = 0.058$ ). This is consistent with the notion that collaborative (prescriptive) national office activates promotion (prevention) focus, and promotion (prevention) focused negotiators are more likely to resort to integrative (distributive) strategy.

Furthermore, under the collaborative national office condition, more participants set a high goal than the prescriptive national office condition (83% vs. 44% set their goal as the maximum amount of accounting adjustments possible,  $t = 2.58$ ,  $p = 0.007$ ), and those working with a collaborative national office are also less fearful of the next inspection than those working with a prescriptive national office (7.81 vs. 5.35,  $t = 3.27$ ,  $p = 0.001$ ). This explorative analysis suggests that a collaborative national office could be beneficial on certain dimensions given PCAOB inspections, that is, audit partners are more likely to have a high negotiation goal (in terms of the amount of accounting adjustments to propose to client management), and are less fearful of the next inspection (although their goal commitment does not differ at a statistically significant level).

## **V. DISCUSSION AND CONCLUSION**

External inspections of auditors' work are key to achieving audit regulator's mandate of improving audit quality (McDonough 2005). Encouraged by audit regulators, audit firms use national office to support audit partners' judgment and to manage inspection process. Recently, researchers note that national offices appear to move from a prescriptive approach where the overarching concern is avoiding being caught as deficient by audit regulators, to a collaborative approach where the goal is to come up with a "best solution" that satisfy multiple stakeholders within the constraint of audit standards (Aghazadeh et al. 2020). Guided by regulatory focus

theory and using a  $2 \times 2$  between subject experiment with 98 audit partners and senior managers, I predict and find that national office's approach towards consultations, along with whether inspection feedback is antagonistic or not (i.e., whether it anchors on failure or opportunities of improvement), affect auditor's judgment at the onset of negotiations with client management over proposed accounting adjustments.

I find that, in an antagonistic audit regulatory environment where inspection feedback anchors on failure, audit partners working with a collaborative national office are less committed to the goal of reducing client's aggressive accounting than partners working with a prescriptive national office. With regards to negotiation strategy choice, perhaps worryingly, all partners are more likely to choose Concede strategies than Expand the Agenda, although they are most likely to choose Problem Solve strategy where they work with their clients to jointly achieve win-win. I find that audit partners working with a collaborative national office prefer tactics that seek to Expand the Agenda more than audit partners working with a prescriptive national office. Thus, in an antagonistic regulatory environment such as what characterizes the relationship between regulator and audit firms in the U.S. (Dowling et al. 2018; Westermann et al. 2018; Peecher et al. 2019), a move towards collaborative national offices could lead to unintended negative consequences during "the last chance to improve financial reporting" (Choudhary et al. 2018). That is, since auditor proposed accounting adjustments are associated with a reduction in earnings management, partners that are less committed to reducing aggressive accounting and more willing to seek win-win with clients may produce more aggressive financial reporting and lower audit quality. Nonetheless, I also find that a collaborative national office is not always detrimental to audit quality. Holding the underlying issues identified during inspection constant, when regulator's inspection feedback anchors on opportunities of improvement as opposed to

failure, audit partners are more committed to curbing aggressive income. However, audit partners receiving inspection feedback anchored on opportunities of improvement are just as likely to use integrative negotiation strategy (Expand the Agenda) as those receiving inspection feedback anchored on failure.

I also find that the identity of audit regulator makes a difference. Given the same inspection feedback, whether the inspection is performed by CPAB or PCAOB leads to different behaviour patterns such that when working with a prescriptive national office, audit partners under joint PCAOB-CPAB inspection are less likely to use Concede or Problem Solve than partners under CPAB inspection. This finding corroborates prior studies documenting higher financial statement quality after PCAOB's inspection programs start in non U.S. regions (Lamoreaux 2016). I also find that, when working with a collaborative national office, audit partners under joint inspection are more committed to reducing aggressive client income and less likely to rely on Expand the Agenda strategy than partners under CPAB inspection. My results are consistent with the interpretation that a collaborative national office mitigates negative consequences of a regulatory environment that is either too friendly (improvement-anchored inspection feedback from CPAB) or too antagonistic (failure-anchored inspection feedback from PCAOB), extending Bauer et al. (2018) who find that regulatory pressure affects auditor behaviour in a reverse U-shape between regulatory pressure and audit task performance quality.

My study makes several contributions. To my knowledge, it is the first experimental study that juxtaposes efforts to improve audit quality within audit firms and outside of audit firms, and finding that both efforts interact but not always in ways that regulators intend. My controlled experiment provides causal evidence that collaborative national offices in an antagonistic regulatory environment could lead to less commitment from audit partners to

reducing earnings management, and more willingness to expand the pie with client to reach win-win. I also experimentally show that some of those negative consequences disappear if regulator's inspection feedback anchors on opportunities of improvement. This finding corroborates researchers' call for change in how audit regulators incentivize auditors to achieve high audit quality (rather than merely avoid falling below a minimum threshold) (Peecher et al. 2013; Aobdia 2018). I also contribute to psychology literature on regulatory focus by showing how two contextual cues interact. I find positive outcomes when contextual cues induce aligned regulatory focus than when contextual cues are not aligned, thus extending prior literature beyond "fit" between how goal frame and assigned goal pursuit strategy.

This paper is subject to limitations with all experimental research. Expert participants are difficult to access, and there is a limited number of audit partners and senior managers. Given my sample size, I have limited direct evidence that regulatory focus mediates my experimental results. However, even with a large sample size, individuals may not be aware of their regulatory focus or its impact on their behaviour (Peecher et al. 2019). Despite these concerns, participants in this study respond to regulatory focus checks in ways that are not inconsistent with my predictions. Second, I only test for pre-negotiation judgment. Future research could examine how (mis)aligned regulatory focus induced by contextual cues leads to negotiation outcomes in dyadic pairs of auditors and clients, such as the actual amount of accounting adjustments recorded. Based on prior literature, I expect that different initial choice of negotiation strategy at the onset is directly related to eventual negotiation outcomes (Yukl 1974; Bame-Aldred and Kida 2007), as is level of commitment (Jordan and Roloff 1997).

## REFERENCES

- Aghazadeh, S., M. K. Dodgson, Y. J. Kang, and M. Peytcheva. 2020. Revealing Oz: Audit firm partners' experiences with national office consultations. *Contemporary Accounting Research* Forthcoming.
- Antle, R., and B. Nalebuff. 1991. Conservatism and Auditor-Client Negotiations. *Journal of Accounting Research* 29 (1991): 31–54.
- Aobdia, D. 2018. The Impact of the PCAOB Individual Engagement Inspection Process-Preliminary Evidence. *The Accounting Review* 93 (4): 53–80.
- Avnet, T., and E. T. Higgins. 2006. How Regulatory Fit Affects Value in Consumer Choices and Opinions. *Journal of Marketing Research*.
- Bame-Aldred, C. W., and T. Kida. 2007. A comparison of auditor and client initial negotiation positions and tactics. *Accounting, Organizations and Society* 32 (6): 497–511.
- Bargh, J. A., and T. L. Chartrand. 1999. The unbearable automaticity of being. *American psychologist* 54 (7): 462.
- Barrick, M. R., G. L. Stewart, and M. Piotrowski. 2002. Personality and job performance: Test of the mediating effects of motivation among sales representatives. *Journal of Applied Psychology* 87 (1): 43–51.
- Bass, B. M. 1999. Two decades of research and development in transformational leadership. *European Journal of Work and Organizational Psychology* 8 (1): 9–32.
- Bauer, T. D., K. V. Hetrick, and J. L. Hobson. 2018. Feedback from inspectors to auditors: Effects of regulatory pressure and auditor mindset on auditor procedure choice. *Working Paper*.
- Bazerman, M. H., and D. A. Moore. 2012. *Judgment in managerial decision making*. New York, NY: John Wiley & Sons.
- Bennett, G. B., R. C. Hatfield, and C. Stefaniak. 2015. The effect of deadline pressure on pre-negotiation positions: A comparison of auditors and client management. *Contemporary Accounting Research* 32 (4): 1507–1528.
- Bobek, D. D., B. E. Daugherty, and R. R. Radtke. 2012. Resolving audit engagement challenges through communication. *Auditing: A Journal of Practice & Theory* 31 (4): 21–45.
- Bowlby, J. 1969. *Attachment (Attachment and loss, Vol. 1)*. New York, NY: Basic Books.
- . 1973. *Separation: Anxiety and anger (Attachment and loss, Vol. 2)*. New York, NY: Basic Books.
- Brockner, J., and E. T. Higgins. 2001. Regulatory focus theory: Implications for the study of emotions at work. *Organizational Behavior and Human Decision Processes* 86 (1): 35–66.
- Brockner, J., E. T. Higgins, and M. B. Low. 2004. Regulatory focus theory and the entrepreneurial process. *Journal of Business Venturing* 19 (2): 203–220.
- Buckless, F. A., and S. P. Ravenscroft. 1990. Contrast coding: A refinement of ANOVA in behavioral analysis. *Accounting Review*: 933–945.
- Canadian Public Accountability Board (CPAB). 2018. *Our Mandate: Canadian Public Accountability Board*.
- Cesario, J., H. Grant, and E. T. Higgins. 2004. Regulatory fit and persuasion: Transfer from “feeling right.” *Journal of Personality and Social Psychology* 86 (3): 388.
- Chen, J., and P. Choudhary. 2020. The Impact of National Office Governance on Audit Quality. *Working paper*. Available at: <https://ssrn.com/abstract=3702083>.
- Choudhary, P., K. J. Merkley, and K. Schipper. 2018. The Last Chance to Improve Financial Reporting Reliability: Evidence from Recorded and Waived Audit Adjustments. *Working paper*. Available at: <https://papers.ssrn.com/abstract=3112957>.
- De Cremer, D., D. M. Mayer, M. van Dijke, B. C. Schouten, and M. Bardes. 2009. When does self-sacrificial leadership motivate prosocial behavior? It depends on followers' prevention focus. *Journal of Applied Psychology* 94 (4): 887–899.

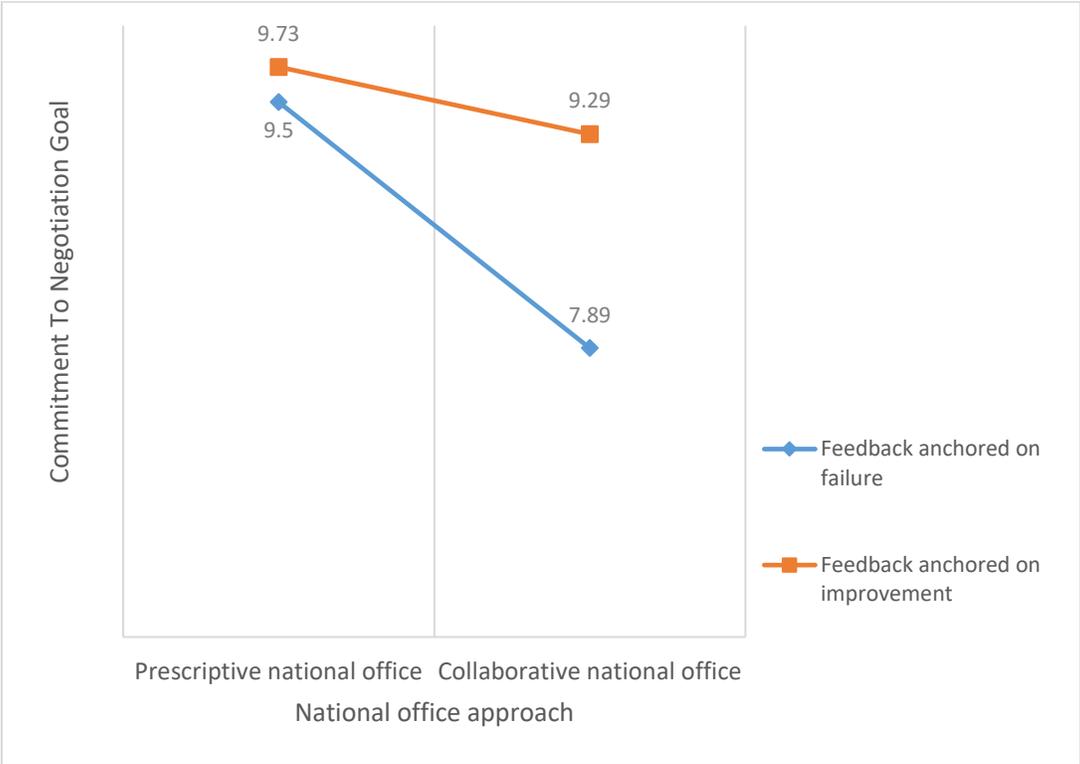
- Crowe, E., and E. T. Higgins. 1997. Regulatory focus and strategic inclinations: Promotion and prevention in decision-making. *Organizational Behavior and Human Decision Processes* 69 (2): 117–132.
- Cunningham, W. A., C. L. Raye, and M. K. Johnson. 2005. Neural correlates of evaluation associated with promotion and prevention regulatory focus. *Cognitive, Affective and Behavioral Neuroscience* 5 (2): 202–211.
- Deloitte. 2019. *2019 Audit Quality Report*.
- Dodgson, M. K., C. P. Agoglia, and G. B. Bennett. 2017. The Effect of Expectancy Violations and Audit Partner Tenure on Client Managers' Negotiation Positions: The Benefits and Implications of Longer Partner Tenure. *Working paper*. Available at: <https://ssrn.com/abstract=3043473>.
- . 2020. The Influence of “Relationship” Partners on Client Managers' Negotiation Positions. *Working paper*. Available at: <https://ssrn.com/abstract=2983280>.
- Dowling, C., W. R. Knechel, and R. Moroney. 2018. Public Oversight of Audit Firms: The Slippery Slope of Enforcing Regulation. *Abacus* 54 (3): 353–380.
- Eddington, K. M., F. Dolcos, R. Cabeza, K. R. R. Krishnan, and T. J. Strauman. 2007. Neural Correlates of Promotion and Prevention Goal Activation: An fMRI Study using an Idiographic Approach. *Journal of Cognitive Neuroscience* 19 (7): 1152–1162.
- EY. 2019. *2019 EY US Transparency Report*.
- Förster, J., E. T. Higgins, and L. C. Idson. 1998. Approach and avoidance strength during goal attainment: regulatory focus and the “goal looms larger” effect. *Journal of personality and social psychology* 75 (5): 1115–1131.
- Freitas, A. L., and E. T. Higgins. 2002. Enjoying goal-directed action: The role of regulatory fit. *Psychological Science* 13 (1): 1–6.
- Fritz, M. S., and D. P. MacKinnon. 2007. Required Sample Size to Detect the Mediated Effect. *Psychological science* 18 (3): 233–239.
- Galinsky, A. D., G. J. Leonardelli, G. A. Okhuysen, and T. Mussweiler. 2005. Regulatory focus at the bargaining table: Promoting distributive and integrative success. *Personality and Social Psychology Bulletin* 31 (8): 1087–1098.
- Gibbins, M., S. A. McCracken, and S. E. Salterio. 2005. Negotiations over accounting issues: The congruency of audit partner and chief financial officer recalls. *Auditing: A Journal of Practice and Theory* 24 (SUPPL.): 171–193.
- Gibbins, M., S. McCracken, and S. E. Salterio. 2010. The auditor's strategy selection for negotiation with management: Flexibility of initial accounting position and nature of the relationship. *Accounting, Organizations and Society* 35 (6): 579–595.
- Gibbins, M., S. Salterio, and A. Webb. 2001. Evidence about auditor-client management negotiation concerning client's financial reporting. *Journal of Accounting Research* 39 (3): 535–563.
- Glover, S. M., D. F. Prawitt, and M. H. Taylor. 2009. Audit standard setting and inspection for U.S. public companies: A critical assessment and recommendations for fundamental change. *Accounting Horizons* 23 (2): 221–237.
- Glover, S. M., M. H. Taylor, Y.-J. Wu, and K. T. Trotman. 2019. Mind the gap: Why do experts have differences of opinion regarding the sufficiency of audit evidence supporting complex fair value measurements? *Contemporary Accounting Research* 36 (3): 1417–1460.
- Gold, A., W. R. Knechel, and P. Wallage. 2012. The effect of the strictness of consultation requirements on fraud consultation. *The Accounting Review* 87 (3): 925–949.
- Griffith, E. E., J. S. Hammersley, K. Kadous, and D. Young. 2015. Auditor mindsets and audits of complex estimates. *Journal of Accounting Research* 53 (1): 49–77.
- Griffith, E. E., C. J. Nolder, and R. E. Petty. 2018. The Elaboration Likelihood Model: A Meta-Theory for Synthesizing Auditor Judgment and Decision Making Research. *Auditing: A Journal of Practice and Theory* 37 (4): 169–186.
- Guggenmos, R. D., M. D. Piercey, and C. P. Agoglia. 2018. Custom contrast testing: current trends and a new approach. *Accounting Review* 93 (5): 223–244.

- Higgins, E. T. 1997. Beyond pleasure and pain. *American Psychologist* 52 (12): 1280.
- . 1998. Promotion and Prevention: Regulatory Focus as A Motivational Principle. *Advances in Experimental Social Psychology* 30 (C): 1–46.
- Higgins, E. T., and J. F. M. Cornwell. 2016. Securing foundations and advancing frontiers: Prevention and promotion effects on judgment & decision making. *Organizational Behavior and Human Decision Processes* 136: 56–67.
- Higgins, T. E., L. C. Idson, A. L. Freitas, S. Spiegel, and D. C. Molden. 2003. Transfer of value from fit. *Journal of Personality and Social Psychology* 84 (6): 1140–1153.
- Hong, J., and A. Lee. 2008. Be Fit and Be Strong: Mastering Self • Regulation through Regulatory Fit. *Journal of Consumer Research* 34 (5): 682–695.
- Idson, L. C., and E. T. Higgins. 2000. How current feedback and chronic effectiveness influence motivation: everything to gain versus everything to lose. *European Journal of Social Psychology* 30 (4): 583–592.
- Idson, L. C., N. Liberman, and E. T. Higgins. 2004. Imagining how you'd feel: The role of motivational experiences from regulatory fit. *Personality and Social Psychology Bulletin*.
- Iyer, V. M., and D. V. Rama. 2004. Clients' Expectations on Audit Judgments: A Note. *Behavioral Research in Accounting* 16 (1): 63–74.
- Johnson, L. M., M. B. Keune, and J. Winchel. 2018. U.S. Auditors' Perceptions of the PCAOB Inspection Process: A Behavioral Examination. *Contemporary Accounting Research*.
- Johnson, R. E., D. D. King, S. H. Joanna Lin, B. A. Scott, E. M. Jackson Walker, and M. Wang. 2017. Regulatory focus trickle-down: How leader regulatory focus and behavior shape follower regulatory focus. *Organizational Behavior and Human Decision Processes* 140: 29–45.
- Jordan, J. M., and M. E. Roloff. 1997. Planning skills and negotiator goal accomplishment: The relationship between self-monitoring and plan generation, plan enactment, and plan consequences. *Communication research* 24 (1): 31–63.
- Kark, R., and D. Van Dijk. 2007. Motivation to lead, motivation to follow: The role of the self-regulatory focus in leadership processes. *Academy of Management Review* 32 (2): 500–528.
- Karoly, P. 1993. Mechanisms of Self-Regulation: A Systems View. *Annual Review of Psychology* 44 (1): 23–52.
- Keller, J., and H. Bless. 2006. Regulatory fit and cognitive performance: the interactive effect of chronic and situationally induced self-regulatory mechanisms on test performance. *European Journal of Social Psychology* 36 (3): 393–405.
- Kline, R. B. 2015. *Principles and practice of structural equation modeling*. Guilford publications.
- Kruglanski, A. W. 2006. The Nature of Fit and the Origins of “Feeling Right”: A Goal-Systemic Perspective. *Journal of Marketing Research* 43 (1): 11–14.
- Lamoreaux, P. T. 2016. Does PCAOB inspection access improve audit quality? An examination of foreign firms listed in the United States. *Journal of Accounting and Economics* 61 (2–3): 313–337.
- Lanaj, K., C.-H. “Daisy” Chang, and R. E. Johnson. 2012. Regulatory focus and work-related outcomes: A review and meta-analysis. *Psychological Bulletin* 138 (5): 998–1034.
- Levin, I. P., S. L. Schneider, and G. J. Gaeth. 1998. All Frames Are Not Created Equal: A Typology and Critical Analysis of Framing Effects. *Organizational Behavior and Human Decision Processes* 76 (2): 149–188.
- Locke, E. A., and G. P. Latham. 1990. *A theory of goal setting and task performance*. Englewood Cliffs, NJ: Prentice-Hall, Inc.
- Malsch, B., and O. Couchoux. 2020. Auditors' strategic and conflicting responses to cpab inspections: acquiescing, compromising, avoiding. *Working Paper*.
- Maslow, A. H. 1955. Deficiency motivation and growth motivation. In *Nebraska symposium on motivation*, edited by M. R. Jones, 1–30. Lincoln, NE: University of Nebraska Press.
- McDonough, W. J. 2005. *Testimony Concerning the PCAOB*. U.S. House of Representatives Committee on Financial Services.

- Molden, D. C., and C. M. Hui. 2011. Promoting de-escalation of commitment: A regulatory-focus perspective on sunk costs. *Psychological Science* 22 (1): 8–12.
- Neubert, M. J., K. M. Kacmar, D. S. Carlson, L. B. Chonko, and J. A. Roberts. 2008. Regulatory Focus as a Mediator of the Influence of Initiating Structure and Servant Leadership on Employee Behavior. *Journal of Applied Psychology* 93 (6): 1220–1233.
- Ng, T., and P. Shankar. 2010. Effects of technical department's advice, quality assessment standards, and client justifications on auditors' propensity to accept client-preferred accounting methods. *Accounting Review* 85 (5): 1743–1761.
- Ng, T., and H. T. Tan. 2003. Effects of authoritative guidance availability and audit committee effectiveness on auditors' judgments in an auditor-client negotiation context. *Accounting Review* 78 (3): 801–818.
- Nunnally, J. 1978. *Psychometric methods*. New York: McGraw-Hill.
- Packer, D. J., and W. A. Cunningham. 2009. Neural correlates of reflection on goal states: The role of regulatory focus and temporal distance. *Social Neuroscience* 4 (5): 412–425.
- Peecher, M. E., M. A. Ricci, and Y. D. Zhou. 2019. Promoting Proactive Auditing Behaviors.
- Peecher, M. E., I. Solomon, and K. T. Trotman. 2013. An accountability framework for financial statement auditors and related research questions. *Accounting, Organizations and Society* 38 (8): 596–620.
- Pham, M. T., and T. Avnet. 2009. Contingent reliance on the affect heuristic as a function of regulatory focus. *Organizational Behavior and Human Decision Processes* 108 (2): 267–278.
- Preacher, K. J., and A. F. Hayes. 2008. Asymptotic and resampling strategies for assessing and comparing indirect effects in multiple mediator models. *Behavior research methods* 40 (3): 879–891.
- Pruitt, D., and P. Carnevale. 1994. *Negotiation in social conflict*. Belmont, CA: Thomson Brooks/Cole Publishing Co.
- Public Company Accounting Oversight Board (PCAOB). 2002. AS 1001: Responsibilities and Functions of the Independent Auditor. <https://pcaobus.org:443/Standards/Auditing/Pages/AS1001.aspx>.
- . 2015. *Concept Release on Audit Quality Indicators*. Washington, D.C.
- PwC. 2019. *2019 Transparency Report - PricewaterhouseCoopers LLP: October 31, 2019*.
- Rahim, M. A. 1983. A measure of styles of handling interpersonal conflict. *Academy of Management journal* 26 (2): 368–376.
- Rogers, C. R. 1960. *A therapist's view of personal goals*. Oxford, England: Pendle Hill.
- Roney, C. J., E. T. Higgins, and J. Shah. 1995. Goals and framing: How outcome focus influences motivation and emotion. *Personality and Social Psychology Bulletin* 21 (11): 1151–1160.
- Salterio, S., and R. Denham. 1997. Accounting consultation units: An organizational memory analysis. *Contemporary Accounting Research* 14 (4): 669–691.
- Salterio, S. E. 2012. Fifteen years in the trenches: Auditor-client negotiations exposed and explored. *Accounting and Finance* 52 (SUPPL.1): 233–286.
- Sanchez, M. H., C. P. Agoglia, and R. C. Hatfield. 2007. The effect of auditors' use of a reciprocity-based strategy on auditor-client negotiations. *Accounting Review* 82 (1): 241–263.
- Scholer, A. A., and E. T. Higgins. 2008. Distinguishing levels of approach and avoidance: An analysis using regulatory focus theory. In *Handbook of approach and avoidance motivation*, edited by A. J. Elliot, 489–503. New York, NY: Psychology Press.
- Stuber, S. B., and C. E. Hogan. 2020. Do PCAOB Inspections Improve the Accuracy of Accounting Estimates? *Journal of Accounting Research*.
- Tan, H. T., and K. T. Trotman. 2010. Effects of the timing of auditors' Income-reducing adjustment concessions on financial officers' negotiation judgments. *Contemporary Accounting Research* 27 (4): 1207–1239.
- Touryan, S. R., M. K. Johnson, K. J. Mitchell, N. Farb, W. A. Cunningham, and C. L. Raye. 2007. The influence of self-regulatory focus on encoding of, and memory for, emotional words. *Social Neuroscience* 2 (1): 14–27.

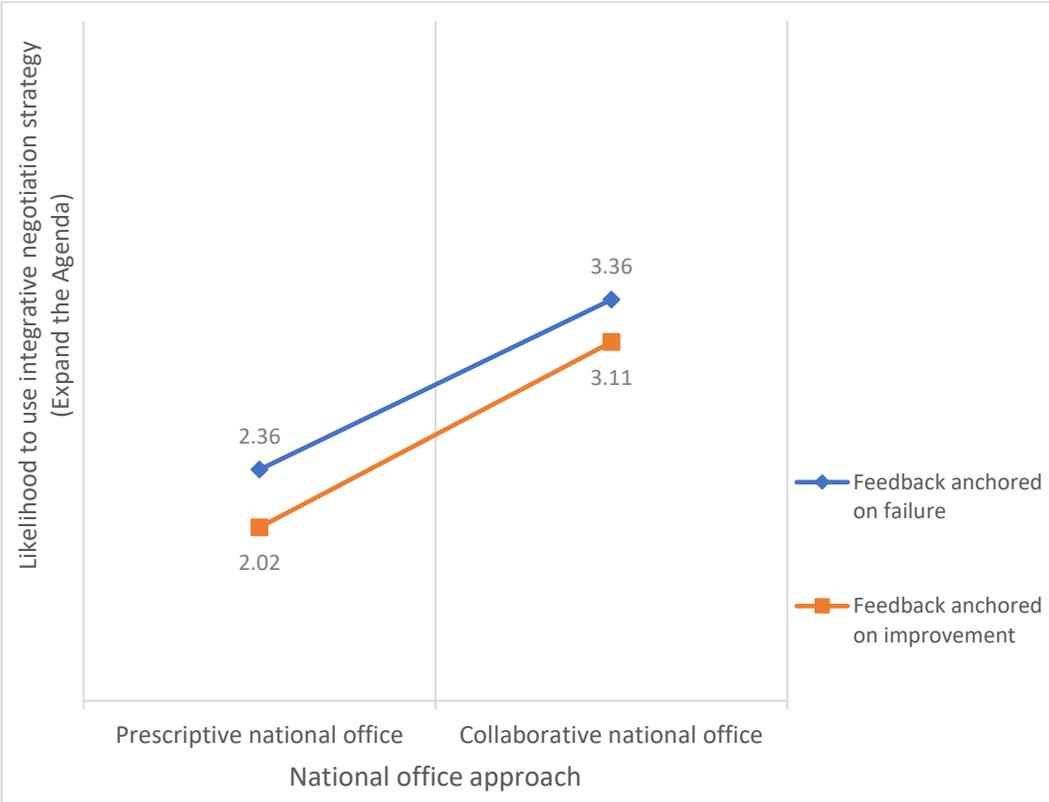
- Trotman, K. T., A. M. Wright, and S. Wright. 2009. An examination of the effects of auditor rank on pre-negotiation judgments. *Auditing: A Journal of Practice and Theory* 28 (1): 191–203.
- Trötschel, R., S. Bündgens, J. Hüffmeier, and D. D. Loschelder. 2013. Promoting prevention success at the bargaining table: Regulatory focus in distributive negotiations. *Journal of Economic Psychology* 38: 26–39.
- U.S. House of Representatives. 2002. *The Sarbanes-Oxley Act of 2002. Public Law 107-204 [H.R. 3763]*. Washington, DC: Government Printing Office.
- Van Dijk, D., and A. N. Kluger. 2004. Feedback Sign Effect on Motivation: Is it Moderated by Regulatory Focus? *Applied Psychology* 53 (1): 113–135.
- . 2011. Task type as a moderator of positive/negative feedback effects on motivation and performance: A regulatory focus perspective. *Journal of Organizational Behavior* 32 (8): 1084–1105.
- Wallace, J. C., and G. Chen. 2006. A multilevel integration of personality, climate, self-regulation, and performance. *Personnel Psychology* 59 (3): 529–557.
- Wallace, J. C., P. D. Johnson, and M. L. Frazier. 2009. An examination of the factorial, construct, and predictive validity and utility of the regulatory focus at work scale. *Journal of Organizational Behavior* 30 (6): 805–831.
- Wang, K. J., and B. M. Tuttle. 2009. The impact of auditor rotation on auditor-client negotiation. *Accounting, Organizations and Society* 34 (2): 222–243.
- Westermann, K. D., J. Cohen, and G. Trompeter. 2018. PCAOB Inspections: Public Accounting Firms on “Trial.” *Contemporary Accounting Research*: Forthcoming.
- Yukl, G. 1974. Effects of the opponent’s initial offer, concession magnitude and concession frequency on bargaining behavior. *Journal of Personality and Social Psychology* 30 (3): 323–335.

**Figure 1** The effect of national office approach and inspection feedback orientation on audit partners' goal commitment



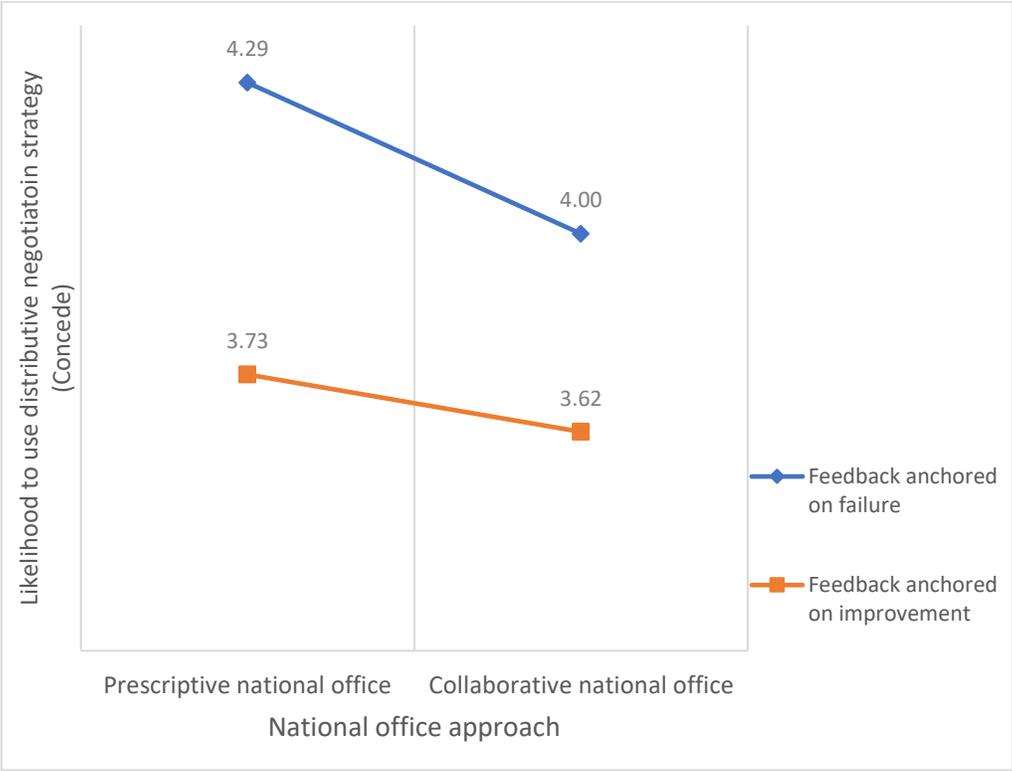
Audit partner's goal commitment is measured on a 11-point scale. Higher numerical values indicating higher commitment to the goal of "achieving a resolution that will result in a substantial reduction in JEL's unaudited net income."

**Figure 2** The effect of national office approach and inspection feedback orientation on audit partners’ use of Expand the Agenda negotiation strategy



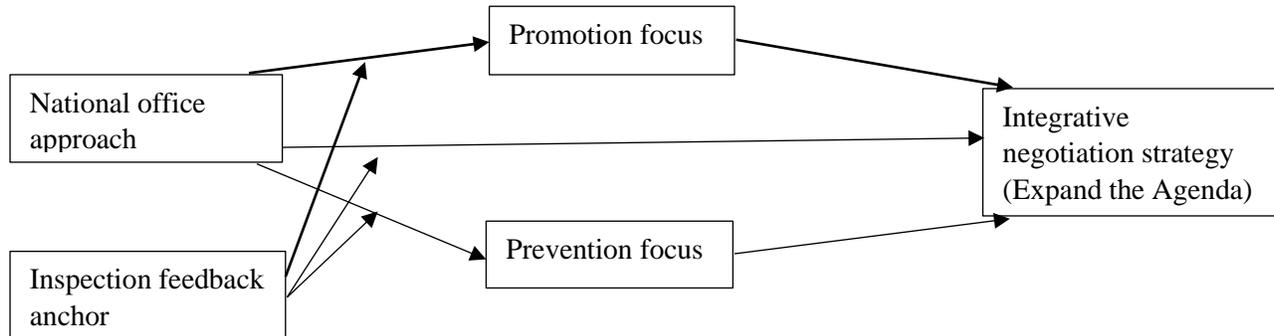
Participant rate on a 8-point scale on how likely they are to use each of the negotiation tactics in Table 2. Tactics 1, 2, and 4 load onto one factor consistent with latent variable integrative negotiation strategy “Expand the Agenda”. I use the average of responses to tactics 1, 2, and 4 as a composite measure for how likely audit partners are to use integrative negotiation strategy (Expand the Agenda). Higher score means greater likelihood to choose the integrative Expand the Agenda strategy.

**Figure 3      The effect of national office approach and inspection feedback orientation on audit partners’ use of Concede negotiation strategy**



Participant rate on a 8-point scale on how likely they are to use each of the negotiation tactics in Table 2. Tactics 6, 7, 8 load onto one factor consistent with latent variable distributive negotiation strategy “Concede”. I use the average of responses to tactics 6, 7, 8 as a composite measure for how likely audit partners are to use distributive negotiation strategy (Concede) Higher score means greater likelihood to choose Concede negotiation strategy.

**Figure 4 Indirect effect of national office approach and inspection feedback orientation on audit partners' use of integrative negotiation strategy (Expand the Agenda) via regulatory focus**



National office → Promotion focus:  $a_{11} = 0.51, p = 0.003$

Inspection feedback → Promotion focus:  $a_{12} = 0.54, p = 0.026$

Interaction of national office and inspection feedback → Promotion focus:  $a_3 = -0.06, p = 0.019$

National office → Prevention focus:  $a_{21} = 0.07, p = 0.633$

Inspection feedback → Prevention focus:  $a_{22} = 0.18, p = 0.374$

Interaction of national office and inspection feedback → Prevention focus:  $a_{23} = -0.01, p = 0.530$

Promotion focus → Integrative negotiation strategy:  $b_1 = -0.65, p = 0.004$

Prevention focus → Integrative negotiation strategy:  $b_2 = -0.02, p = 0.925$

National office → Integrative negotiation strategy:  $c_1 = 0.26, p = 0.338$

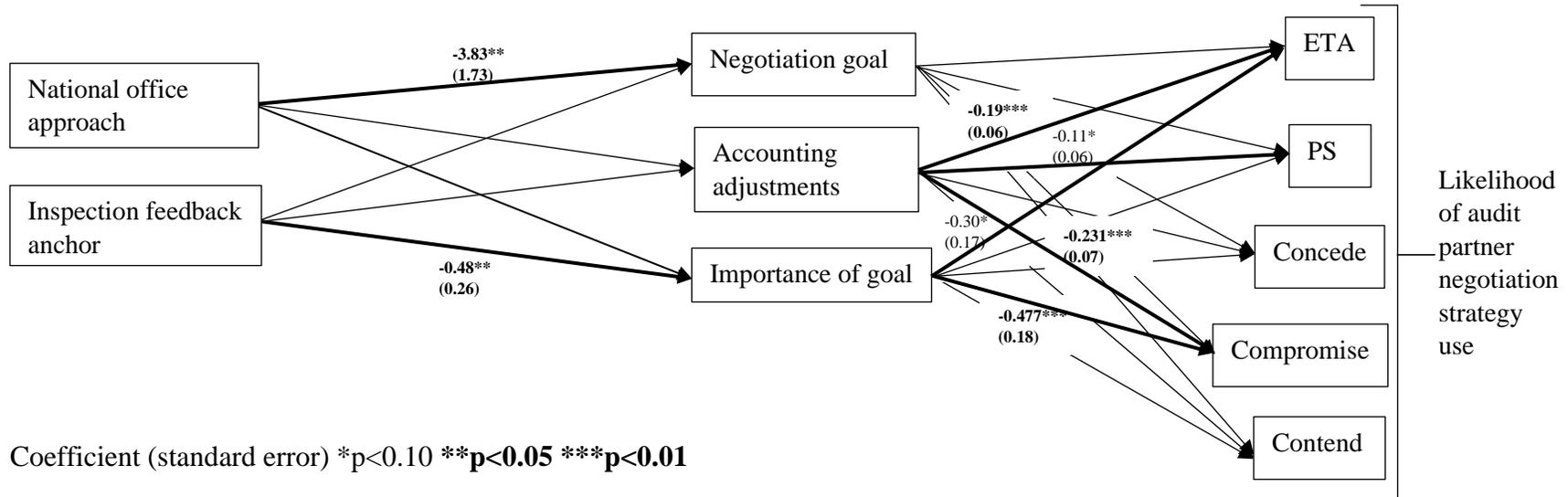
Inspection feedback → Integrative negotiation strategy:  $c_2 = 0.53, p = 0.162$

Interaction of national office and inspection feedback → Integrative negotiation strategy:  $c_3 = -0.04, p = 0.345$

Figure 4 depicts the coefficients of the indirect effect of national office approach and inspection feedback orientation on audit partners' commitment to their goals via regulatory focus for the four main experimental conditions. I follow Preacher and Hayes (2008) bootstrapping approach (PROCESS model 8), where confidence intervals are bias-corrected intervals for the estimate of the indirect effect, estimated using 5,000 bootstrapped re-samples of the data with replacement.

National office approach is measured on a 11-point scale, with higher value indicating more prescriptive national office. Inspection feedback orientation is measured on an 11-point scale, with higher value indicating more antagonistic inspection feedback. Promotion focus is measured on a 7-point scale to the question "You stated your accounting adjustments goal in your discussion with JEL management above (question #2). How important is this goal to you", with higher value indicating a higher promotion focus. Prevention focus is measured on a 7-point scale to the question "You stated the minimum accounting adjustments you would accept in your discussion with JEL management above (question #3). How important is this minimum amount to you", with higher value indicating greater prevention focus.

**Figure 5 Path analysis of national office approach and inspection feedback orientation on negotiation strategy and negotiation judgment**



Coefficient (standard error) \* $p < 0.10$  \*\* $p < 0.05$  \*\*\* $p < 0.01$

Note: The path analysis is conducted on the four main experimental conditions ( $n = 83$ ) using maximum likelihood with missing values (results remain the same using bootstrapping method). National office approach refers to national office’s approach to consultations, manipulated as either prescriptive or collaborative. Feedback refers to inspection feedback anchor, manipulated as either anchored on failure or opportunities of improvement. ETA refers to Expand the Agenda strategy; PS refers to Problem Solve strategy. See Table 2 for tactics that underlie each of the negotiation strategy. Negotiation goal refers to the amount of accounting adjustments audit partners would like to achieve, elicited as a numerical input. Accounting adjustments refers to the amount of accounting adjustments audit partners would propose, elicited through a scale from \$0 (no adjustment) to \$35.7 million (book all adjustments that the audit team suggests). Importance of goal refers to the question “You stated your accounting adjustments goal in your discussion with JEL management above (question #2). How important is this goal to you”, elicited via a 7-point scale, with higher score indicating greater importance.

**Table 1 Descriptive statistics of experiment participants**

**Panel A: Participant inclusion and exclusion**

|  |           |
|--|-----------|
| Total number of times the online study is accessed                     | 131       |
| Incomplete answers (do not proceed beyond the case)                    | 32        |
| Unqualified participants (< 1 year of experience in public accounting) | <u>1</u>  |
| <b>Participants included in statistical analysis</b>                   | <b>98</b> |

**Distribution by condition**

|  |           |
|--|-----------|
| Main experimental conditions:  |           |
| Inspection feedback anchored on failure  |           |
| Prescriptive national office   | 16        |
| Collaborative national office  | 15        |
| Inspection feedback anchored on opportunities of improvement   |           |
| Prescriptive national office   | 16        |
| Collaborative national office  | 15        |
| Additional conditions: inspection feedback anchored on failure but delivered by joint PCAOB-CPAB inspection rather than from CPAB inspection |           |
| Collaborative national office  | 18        |
| Prescriptive national office   | <u>18</u> |
| <b>Total</b>   | <b>98</b> |

**Panel B: Number (percentage) of participants with inspection experience from CPAB, joint PCAOB-CPAB, or neither**

|   |    |       |
|---|----|-------|
| CPAB inspection                           | 77 | (79%) |
| Joint PCAOB-CPAB inspection               | 41 | (42%) |
| None of PCAOB, CPAB, or joint inspections | 16 | (16%) |

**Panel C: Participant position at their firm**

|                             |           |
|-----------------------------|-----------|
| <b>Position at the firm</b> |           |
| Partner                     | 60        |
| Senior manager              | 26        |
| Manager                     | 0         |
| Other                       | 0         |
| Missing answer              | <u>12</u> |
| <b>Total</b>                | <b>98</b> |

**Table 2 List of negotiation tactics and likelihood to use**

| <b>No.</b>   | <b>Negotiation tactic*</b>  | <b>Likelihood of use<br/>Mean (SD)</b> | <b>Factor loadings<br/>(&gt;0.5)</b> |
|--|---|--|--------------------------------------|
| <i>Panel A: Expand the Agenda strategy's tactics</i> |   |  |                                      |
| 1  | Bring other issues to the discussion, such that I could trade off on other issues to resolve this issue in my favour.             | 2.91*** (1.93)                         | 0.864                                |
| 2  | Attempt to find other issues with JEL, so I could accede to their wishes at the same time as achieving my position on this issue. | 2.51*** (1.69)                         | 0.872                                |
| 3  | Provide all relevant information to JEL's management so we could solve this issue together in the context of other issues.        | 7.33*** (1.39)                         | N/A                                  |
| 4  | Attempt to find other issues with JEL, which I could add to the discussion.   | 2.47*** (1.65)                         | 0.830                                |
| 5  | Try to work with JEL's management to develop a proper understanding of this issue in the context of other issues.                 | 7.23*** (1.15)                         | N/A                                  |
| <i>Panel B: Concede strategy's tactics</i>           |   |  |                                      |
| 6  | Try to satisfy the expectations of JEL's management.  | 3.75* (1.70)                           | 0.787                                |
| 7  | Attempt to accommodate the wishes of JEL's management.  | 3.33*** (1.70)                         | 0.824                                |
| 8  | Try to satisfy the needs of JEL's management.   | 3.93 (1.88)                            | 0.849                                |
| 9  | Make concessions from my position to JEL's management.  | 3.06*** (1.43)                         | N/A                                  |
| 10   | Give in to the wishes of JEL's management.  | 1.55*** (0.97)                         | N/A                                  |
| <i>Panel C: Compromise strategy's tactics</i>        |   |  |                                      |
| 11   | Try to play down the differences with JEL's management to reach a compromise.   | 3.10*** (1.88)                         | 0.780                                |
| 12   | Use "give and take" so that a compromise could be made with JEL' s management.  | 4.16 (2.09)                            | 0.759                                |
| 13   | Negotiate with JEL's management so that a compromise could be reached.  | 4.45** (2.17)                          | 0.753                                |
| <i>Panel D: Contend strategy's tactics</i>           |   |  |                                      |
| 14   | Argue with JEL's management to show them the merits of my position.   | 4.19 (2.21)                            | N/A                                  |
| 15   | Use my influence to get my position accepted by JEL's management.   | 5.38*** (1.98)                         | 0.768                                |
| 16   | Use my expertise in accounting to influence the resolution in my favour.  | 6.59*** (1.26)                         | 0.569                                |
| 17   | Remain firm with my initial proposed accounting adjustment.   | 5.85*** (1.55)                         | 0.666                                |

*Panel E: Problem Solve strategy's tactics*

---

|    |   |                |       |
|----|---|----------------|-------|
| 18 | Try to work with JEL's management to find new solutions to this issue that satisfy both of our expectations.  | 6.31*** (1.79) | 0.766 |
| 19 | Try to investigate the issue further with JEL's management to find a new solution acceptable to both of us.   | 6.63*** (1.68) | 0.838 |
| 20 | Try to bring all my concerns about this issue out into the open with JEL's management so that the issue could be resolved in the best possible way. | 7.41*** (0.99) | N/A   |
| 21 | Try to integrate my ideas about how to resolve this issue with JEL's management to come up with a new solution jointly.                             | 6.20*** (1.76) | 0.789 |

Note: Auditors indicate on an 8-point scale ranging from 0 (“very unlikely to use”) to 7 (“very likely to use”) how likely they are to use each of the 21 tactics that are either integrative (“Expand the Agenda” and “Problem Solve” strategies that seek win-win) or distributive (Contend, Concede, or Compromise strategies that result in one party wins or neither party wins) (recoded to 1 to 8). The order of the negotiation tactics is randomized for participants.

\*, \*\*, \*\*\* indicates significantly different from midpoint at 0.1, 0.05, and 0.001 levels.

**Table 3      Negotiation goal measures**

**Panel A: Audit partner’s negotiation goals, mean (SD) [N]**

| <b>Negotiation goal</b>       | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection anchored on failure |
|-------------------------------|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office  | 33.44<br>(5.25)<br>[16]             | 32.80<br>(4.01)<br>[16]                                  | 33.12<br>(4.60)<br>[32]        | 31.60<br>(6.09)<br>[18]                            |
| Collaborative national office | 28.86<br>(10.13)<br>[15]            | 29.73<br>(7.48)<br>[15]                                  | 29.29<br>(8.76)<br>[30]        | 33.28<br>(5.71)<br>[18]                            |
| Means (SD) for feedback       | 31.23<br>(8.19)<br>[31]             | 31.31<br>(6.05)<br>[31]                                  | 31.27<br>(7.14)<br>[62]        | 32.44<br>(5.88)<br>[36]                            |

Audit partner’s negotiation goal is elicited by the question “What amount of accounting adjustments, if any, would be your goal in your discussion with JEL’s management to resolve the differences between your audit team and the client?” Higher numbers indicate larger accounting adjustments, or more conservative accounting income.

**Table 4 Goal commitment measures**

**Panel A: Audit partner’s commitment to the goal of reducing client’s income, raw mean (SD) [N]**

| <b>Commitment to the goal of reducing client income</b> | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection anchored on failure |
|---|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office                            | 9.5<br>(1.91)<br>[14]<br>{1}        | 9.73<br>(1.75)<br>[15]                                   | 9.62<br>(1.80)<br>[29]         | 9.69<br>(2.12)<br>[16]                             |
| Collaborative national office                           | 7.9<br>(1.73)<br>[12]<br>{2}        | 9.29<br>(1.82)<br>[14]<br>{3}                            | 8.71<br>(1.88)<br>[24]         | 9.76<br>(1.89)<br>[16]                             |
| Means (SD) for feedback                                 | 8.83<br>(1.97)<br>[26]              | 9.52<br>(1.77)<br>[29]                                   | 9.21<br>(1.87)<br>[53]         | 9.73<br>(1.97)<br>[33]                             |

Commitment is measured on a 11-point scale from 0 to 10, higher numerical value indicates higher commitment to the goal of “achieving a resolution that will result in a substantial reduction in JEL's unaudited net income.”

**Panel B: Audit partner’s commitment to the goal of reducing client’s income, adjusted mean (SD) [N]**

| <b>Commitment to the goal of reducing client income</b> | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection (anchored on failure) |
|---|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office                            | 9.5<br>(0.19)<br>[14]               | 9.73<br>(0.12)<br>[15]                                   | 9.62<br>(0.19)<br>[29]         | 9.57<br>(0.28)<br>[16]                               |
| Collaborative national office                           | 7.94<br>(0.27)<br>[12]              | 9.29<br>(0.30)<br>[14]                                   | 8.66<br>(0.74)<br>[26]         | 9.31<br>(0.22)<br>[16]                               |
| Means (SD) for feedback                                 | 8.78<br>(0.83)<br>[26]              | 9.52<br>(0.32)<br>[29]                                   | 9.17<br>(0.71)<br>[55]         | 9.44<br>(0.28)<br>[32]                               |

Commitment is measured on a 11-point scale from 0 to 10, higher numerical value indicates higher commitment to the goal of “achieving a resolution that will result in a substantial

reduction in JEL's unaudited net income.” Sample mean adjusted for controls (firm type and audit partners’ negotiation goal).

**Panel C: 2 × 2 ANOVA**

| Source of variation                             | Df       | MS           | F           | p-value      |
|---|----------|--------------|-------------|--------------|
| <b>Model</b>                                    | <b>6</b> | <b>6.41</b>  | <b>2.05</b> | <b>0.079</b> |
| <b>National office approach</b>                 | <b>1</b> | <b>9.72</b>  | <b>3.10</b> | <b>0.085</b> |
| <b>Inspection feedback orientation</b>          | <b>1</b> | <b>11.57</b> | <b>3.69</b> | <b>0.061</b> |
| Feedback orientation × National office approach | 1        | 7.30         | 2.33        | 0.134        |
| Control: firm type                              | 2        | 7.16         | 2.28        | 0.114        |
| Control: negotiation goal                       | 1        | 3.96         | 1.26        | 0.267        |
| Residual  | 46       | 3.14         |             |              |

National office is manipulated as having either a prescriptive or collaborative approach towards consultations. Inspection feedback is manipulated as either anchored on failure or improvement. I control for firm type (whether participants work for big 4, medium size, or other types of firms) and negotiation goal (numerical amount of accounting adjustments participants indicated as their goal in discussion with client management). Dropping the controls result in qualitatively similar results (significant main effect of national office approach,  $p < 0.05$ , and main effect of inspection feedback approaching significance,  $p = 0.11$ ). Results are two-tailed.

**Panel D: ANOVA post hoc tests**

|   | F value     | p-value       |
|---|-------------|---------------|
| <b>Prescriptive national office &gt; Collaborative national office given “failure” feedback; {1}&gt;{2}</b>               | <b>4.88</b> | <b>0.0321</b> |
| <b>Feedback anchored on improvement &gt; Feedback anchored on failure given collaborative national office; {3}&gt;{2}</b> | <b>5.25</b> | <b>0.0267</b> |

**Panel E: Contrast testing using [+1, -3, +1, +1]**

| Source                          | SS           | df       | MS           | F-statistic | p-value      |
|---------------------------------|--------------|----------|--------------|-------------|--------------|
| <b>Contrast</b>                 | <b>20.93</b> | <b>1</b> | <b>20.93</b> | <b>6.40</b> | <b>0.015</b> |
| Residual between-cells variance | 1.60         | 2        | 0.80         | 0.24        | 0.784        |
| Total between-cells variance    | 22.53        | 3        | 7.51         | 2.30        | 0.089        |
| Error                           | 160.19       | 49       | 3.27         |             |              |
| Total                           | 182.72       | 52       |              |             |              |

**Table 5 Expand the Agenda negotiation strategy measures**

**Panel A: Participant’s use of integrative negotiation strategy Expand the Agenda, mean (SD) [N]**

| <b>Likelihood to use integrative negotiation strategy (Expand the Agenda)</b> | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection (anchored on failure) |
|---|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office  | 2.36<br>(1.60)<br>[15]<br>{1}       | 2.02<br>(1.14)<br>[15]                                   | 2.19<br>(1.37)<br>[30]         | 2.80<br>(1.55)<br>[17]                               |
| Collaborative national office   | 3.36<br>(1.49)<br>[14]<br>{2}       | 3.11<br>(1.60)<br>[15]<br>{3}                            | 3.23<br>(1.52)<br>[29]         | 2.46<br>(1.63)<br>[18]                               |
| Means (SD) for feedback   | 2.84<br>(1.60)<br>[29]              | 2.57<br>(1.47)<br>[30]                                   | 2.70<br>(1.53)<br>[59]         | 2.63<br>(1.58)<br>[35]                               |

Participant rate on a 8-point scale on how likely they are to use each of the negotiation tactics in Table 2. Tactics 1, 2, and 4 load onto one factor consistent with latent variable integrative negotiation strategy “Expand the Agenda”. I use the average of responses to tactics 1, 2, and 4 as a composite measure for how likely audit partners are to use integrative negotiation strategy (Expand the Agenda).

**Panel B: 2 × 2 ANOVA with dependent variable likelihood to use integrative negotiation strategy Expand the Agenda**

| Source of variation                             | Df       | MS           | F           | p-value      |
|---|----------|--------------|-------------|--------------|
| <b>Model</b>                                    | <b>3</b> | <b>5.75</b>  | <b>2.67</b> | <b>0.056</b> |
| <b>National office approach</b>                 | <b>1</b> | <b>16.10</b> | <b>7.48</b> | <b>0.008</b> |
| Inspection feedback orientation                 | 1        | 1.24         | 0.57        | 0.452        |
| Feedback orientation × National office approach | 1        | 0.03         | 0.01        | 0.910        |
| Residual  | 55       | 2.15         |             |              |

**Panel C: ANOVA post hoc tests**

|  | F value     | p value      |
|--|-------------|--------------|
| <b>Prescriptive national office &lt; Collaborative national office given “failure” feedback; {1}&lt;{2}</b>  | <b>3.37</b> | <b>0.072</b> |
| Feedback anchored on improvement < Feedback anchored on failure given collaborative national office; {3}<{2} | 0.20        | 0.654        |

**Panel D: Contrast testing using [-1, +3, -1, -1]**

| <b>Source</b>                   | <b>SS</b>   | <b>df</b> | <b>MS</b>   | <b>F-statistic</b> | <b>p-value</b> |
|---------------------------------|-------------|-----------|-------------|--------------------|----------------|
| <b>Contrast</b>                 | <b>7.91</b> | <b>1</b>  | <b>7.91</b> | <b>3.67</b>        | <b>0.061</b>   |
| Residual between-cells variance | 9.34        | 2         | 4.67        | 2.17               | 0.124          |
| Total between-cells variance    | 17.25       | 3         | 5.75        | 2.67               | 0.056          |
| Error                           | 118.46      | 55        | 2.15        |                    |                |
| Total                           | 135.71      | 58        |             |                    |                |

**Table 6 Problem Solve negotiation strategy measures**

**Panel A: Participant’s use of integrative negotiation strategy Problem Solve, mean (SD) [N]**

| <b>Likelihood to use integrative negotiation strategy (Problem Solve)</b> | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection (anchored on failure) |
|---|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office  | 6.80<br>(1.34)<br>[15]              | 6.18<br>(1.61)<br>[15]                                   | 6.49<br>(1.49)<br>[30]         | 5.86<br>(1.48)<br>[17]                               |
| Collaborative national office   | 6.62<br>(1.36)<br>[14]              | 6.22<br>(1.38)<br>[15]                                   | 6.41<br>(1.36)<br>[29]         | 6.59<br>(1.16)<br>[18]                               |
| Means (SD) for feedback   | 6.71<br>(1.33)<br>[29]              | 6.20<br>(1.47)<br>[30]                                   | 6.45<br>(1.42)<br>[59]         | 6.24<br>(1.35)<br>[35]                               |

Participant rate on a 8-point scale on how likely they are to use each of the negotiation tactics in Table 2. Tactics 18, 19, 21 load onto one factor consistent with latent variable negotiation strategy “Problem Solve”. I use the average of responses to tactics 18, 19, 21 as a composite measure for how likely audit partners are to use Problem Solve strategy.

**Table 7 Concede negotiation strategy measures**

**Panel A: Participant’s use of distributive negotiation strategy (Concede), mean (SD) [N]**

| <b>Likelihood to use distributive negotiation strategy (Concede)</b> | Feedback anchored on failure (CPAB) | Feedback anchored on opportunities of improvement (CPAB) | Means (SD) for national office | Feedback from joint inspection (anchored on failure) |
|--|-------------------------------------|--|--------------------------------|--|
| Prescriptive national office   | 4.29<br>(1.08)<br>[15]              | 3.73<br>(1.84)<br>[15]                                   | 4.01<br>(1.50)<br>[30]         | 3.06<br>(1.32)<br>[17]                               |
| Collaborative national office  | 4.00<br>(1.91)<br>[14]              | 3.62<br>(1.54)<br>[15]                                   | 3.80<br>(1.71)<br>[29]         | 3.59<br>(1.09)<br>[18]                               |
| Means (SD) for feedback  | 4.15<br>(1.52)<br>[29]              | 3.68<br>(1.66)<br>[30]                                   | 3.91<br>(1.60)<br>[59]         | 3.33<br>(1.22)<br>[35]                               |

Participant rate on a 8-point scale on how likely they are to use each of the negotiation tactics in Table 2. Tactics 6, 7, 8 load onto one factor consistent with latent variable distributive negotiation strategy “Concede”. I use the average of responses to tactics 6, 7, 8 as a composite measure for how likely audit partners are to use Concede strategy.

## Appendix 1 Tabulation of manipulations

### Panel A national office approach

| <b>Prescriptive</b><br>(prevention focus)  | <b>Collaborative</b><br>(promotion focus)  |
|--|--|
| The national office has a formal consulting process, <u>requiring formal documentation (usually a memo) about the issue prior to the formal consultation.</u>  | The national office has a formal consulting process <u>but is also accessible for informal consultations over the phone.</u>   |
| You have observed that the national office is very concerned with <u>being compliant with external regulators such as the PCAOB and CPAB and emphasizes providing strong defense against second-guessing by regulators.</u> The national office emphasizes <u>following formal procedures of consultation, including writing up formal memos prior to initiating consulting with the national office.</u> In addition to the documentation requirement, the national office usually takes an <u>authoritative approach to consultations, providing prescriptive “final say” on issues consulted.</u> The final issue resolution memos are subject to national office review. | You have observed that the national office is very concerned with <u>supporting the engagement team to arrive at a well-supported conclusion through collaboration with you and your audit team.</u> The national office has a formal consulting process, but has also been available to you over the phone for informal, <u>verbal consultations through which you have checked your tentative conclusions.</u> In addition, the national office usually takes a <u>collaborative approach to consultations, leaving you with the ownership of the issue including ensuring the results are documented in the audit file.</u> |

### Panel B Inspection feedback style

| <b>Failures</b><br>(prevention focus)  | <b>Opportunities of improvement (CPAB)</b><br>(promotion focus)   |
|--|---|
| <p>One of your engagements (not JEL) was inspected. The following paragraph was noted in the report issued by CPAB.</p> <p>“The firm <u>failed</u> to critically evaluate the reasonableness of the issuer’s revenue recognition prior to reaching its conclusion. Specifically,</p> <ul style="list-style-type: none"> <li>• In determining whether or not the issuer’s analysis was reasonable, <u>the firm failed to consider</u> evidence that contradicted the issuer’s conclusion or supported an alternative conclusion.</li> </ul> | <p>One of your engagements (not JEL) was inspected. The following paragraph was noted in the report issued by CPAB.</p> <p>“The firm <u>has not achieved high quality in</u> critically evaluating the reasonableness of the issuer’s revenue recognition prior to reaching its conclusion. Specifically,</p> <ul style="list-style-type: none"> <li>• In determining whether or not the issuer’s analysis was reasonable, <u>the firm did not achieve high quality judgment in considering</u> evidence that contradicted the issuer’s conclusion or supported an alternative conclusion.</li> </ul> |

|  |   |
|--|---|
| <ul style="list-style-type: none"> <li>• The firm <u>failed to evaluate</u> the issuer’s likelihood of achieving its assumptions, including whether management had the ability to carry out its plans and whether those plans could produce the projected results.”</li> </ul> <p>Recurring inspection themes indicate that <u>failures in this area persist.</u>”</p> | <ul style="list-style-type: none"> <li>• The firm <u>did not achieve high quality judgment in evaluating</u> the issuer’s likelihood of achieving its assumptions, including whether management had the ability to carry out its plans and whether those plans could produce the projected results.”</li> </ul> <p>Recurring inspection themes indicate that <u>high quality audit in this area has not been achieved.</u> Each firm continues to make effort to improve, and CPAB acknowledges that the firms are rethinking how they deliver higher audit quality.”</p> |
|--|---|

## Appendix 2 Example of PCAOB's and CPAB's inspection report

### Panel A: PCAOB's findings excerpt (emphasis added)

|  |
|--|
| (1) the <b>failure</b> , in an audit of ICFR, to perform sufficient procedures to test the design and operating effectiveness of controls over the valuation of property, plant, and equipment ("PPE") (AS 2201.39, .42, and .44); and |
| (2) the <b>failure</b> to perform sufficient procedures to test the valuation of PPE (AS 2501.11 and .12).   |
| (3) the <b>failure</b> , in an audit of ICFR, to perform sufficient procedures to test the design and operating effectiveness of controls over the valuation of mining interests (AS 2201.39, .42, and .44); and                       |
| (4) the <b>failure</b> to perform sufficient procedures to test the valuation of mining interests (AS 2502.26, .28, .36, and .40).   |
| (5) the <b>failure</b> to perform sufficient procedures to test the valuation of intangible assets (CAS 9 500.08; CAS 540.18); and   |
| (6) the <b>failure</b> to perform sufficient procedures to test the occurrence and completeness of revenue (CAS 330.06, .07 and .21).  |
| (7) the <b>failure</b> to perform sufficient procedures to test the occurrence of revenue (AS 2301.08 and .13).  |

### Panel B: CPAB's findings excerpt (emphasis added)

|  |
|--|
| Inspection findings indicate that auditors <b>often</b> avoid testing the controls by 'auditing around' the computer system.   |
| Insufficient or ineffective audit procedures, or reliance on audit evidence of limited value.  |
| If the auditor does not <b>fully</b> understand the terms of service contract and how those services will be performed and invoiced, key performance obligations that must be met before revenue can be recognized may be missed. As a result, the testing <b>may</b> not provide evidence that revenue was recorded according to accounting requirements. |
| The auditor <b>may</b> incorrectly assess the value of audit evidence. For example, if an auditor relies on a confirmation from a third party service provider to support the revenue reported but that third party obtains the underlying information from the company itself, the confirmation is not independent evidence.                              |

Note: Panel A is an excerpt from PCAOB's inspection of a Canadian Big 4 office for audits conducted for the year ended December 31, 2015. Panel B is an excerpt from CPAB's inspection of a Canadian Big 4 office for audits conducted for the year ended December 31, 2015.