

THE UNIVERSITY OF HULL

**Auditor Selection of Negotiation Strategies: The Effect of Motivational
Factors and Bargaining Power under a Throughput Model**

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ABSTRACT

Motivational factors and bargaining power have been recognized by scholars and practitioners alike, as important elements for negotiation strategies. However, there has been little effort to date to empirically or theoretically study the effect of these factors in the context of auditor-client negotiation while adopting a decision-making process framework. We present a Throughput Model framework that describes the decision-making process of auditors when they make decisions about negotiation strategies. The model depicts how (a) perception of motivational factors and (b) bargaining power affect the choice of negotiation strategy and identifies different pathways auditors use in their decision about negotiation strategies.

In our experiment, we manipulate engagement risk perception, client pressure, corporate mechanisms strength as well as financial information. We investigate their effects on auditor decision making about the likelihood of accepting client's management alternative and on the negotiation strategies choice. We find that only engagement risk perception influences auditor's propensity to accept aggressive accounting treatments of the client. This in turn influences the use of all the negotiation strategies. On the other hand, client pressure only has effect on compromising strategies while bargaining power influences the concessionary strategy of auditors. Moreover, two dominant decision making pathways are used by auditors, i.e. $P \rightarrow J \rightarrow D$ and $P \rightarrow D$.

Keywords: Auditor negotiation, engagement risk; client pressure, throughput model, decision, judgment

Chapter 1: Introduction

1.1 Background and Motivation

Auditors often find themselves in situations where they have to negotiate with their clients over controversial accounting issues for which accounting standards are vague (Peecher, 1996). Self-interested managers could use this vagueness to legitimate aggressive accounting alternatives (Nelson et al., 2002). Auditors generally push back against such management tactics and this constrains management actions because they fear receiving a modified opinion. For example, auditors sometimes approve the client's alternative in order to maintain their auditor-client relationship, although this would more than likely, increase their litigation exposure. This contentious situation suggests that both the auditor and the client have a mutual interest for negotiation, and choose among several acceptable reporting options (Antle and Nalebuff, 1991; Gibbins et al., 2001).

The auditor's report and the financial statements are thus considered joint products of auditors and management (Antle and Nalebuff, 1991), although the ultimate responsibility for financial statements and related disclosures remains with the management of the reporting company. When an accounting adjustment is required, it will be recorded or the disclosure will be made only if the auditor successfully persuades management to approve the proposed adjustment or disclosure. Thus, the auditing-accounting environment is described as a "large negotiation system" (Murnighan and Bazerman, 1990).

Auditors' failure to effectively negotiate adjustments may harm investors or any other stakeholders who rely on the possibly misleading financial reports to make decisions,

this in turn could lead to courts or administrative agencies like the Securities and Exchange Commission (SEC) imposing civil penalties on the auditor and auditee. Furthermore, it may, in extreme cases, contribute to economic hardship, collapse of businesses, and criminal conviction (e.g., Enron) of parties involved.

When auditor negotiation strategies fail to persuade a difficult client and no mutually acceptable position is reached, auditors are faced with the possible loss of a client if they hold their ground, or increase their reputational risk if they give in to the client's demands (see figure 1 below). Research has shown that the choice of negotiation strategy given different audit circumstances has an effect on negotiation outcomes. In light of this, auditor choice of negotiation strategy becomes very important given its potential impact on financial statements, auditor reputation, and professional survival (Gibbins et al., 2001; Johnstone and Muzatko, 2002).

	Conservative accounting treatments	Aggressive accounting treatments
Accept	Correct	Reputational risk
Reject	Losing the job	Correct

Figure 1 Auditor's Acceptance Decision

Source: The author

Previous research has studied the negotiation strategies that auditors may pursue when they resolve contentious accounting issues. Fundamentally, the objective of this research was to study under what condition they follow a specific negotiation approach and this includes individuals' characteristics and contextual features related to the auditing environment.

In this light, self-interest and concern for others' perceptions are particularly useful when auditors decide on the particular negotiation approach; they believe it would allow them the best negotiation outcome. Generally speaking, a high self-interest concern results in a hostile negotiation approaches whereas a high concern for others results in approaches that are more conciliatory.

However, other incentives come into play for the negotiation strategies decision choice. Indeed, negotiation researchers have provided evidence that bargaining power is an important factor that influences this choice. In fact, the greater the auditor's power relative to the clients, the more adjustments they should be able to claim and more contending behaviour will be likely to be used (Ng and Tan, 2003).

Understanding auditors' behaviours as negotiators could be improved by better understanding the psychology of the bargaining behaviour, especially the decision-making processes used in negotiation. We propose using Rodgers' (1997) Throughput Model which identifies important pathways for the decision making process.

The Throughput Model has four components: perception (P), information (I), judgment (J) and decision choice (D). In the first stage, both perception and information influence judgment. In the second stage, perception and judgment influence decision choice (Foss and Rodgers, 2011). The Throughput model offers insights from social psychology into a descriptive model of how negotiators make decisions. The use of the Throughput model is proposed in this research because it enables studying the effects of auditors' perceptions about the engagement risk, client pressure, corporate governance mechanisms and financial information; all factors that have been identified as influencing the selection of auditor negotiation strategy.

Therefore, we propose that financial information and perception of contextual features leads to judgment related to proposed adjusted entries which leads to negotiation strategies decision choice. The conceptual foundation of this proposition follows.

1.2 Conceptual Foundation

Negotiation strategies are reflective of auditor's perception of accounting and auditing contextual features, their individual skills and the interpersonal relationship (Gibbins et al., 2001). Explanations as to how these factors affect negotiation strategies are partly rooted at the dual concern theory and at the bargaining power. Therefore, the extent of using conciliatory behaviour versus a competitive one will depend on how these factors impact their self-interest and their concern for the clients on one hand, and how they affect their bargaining power on the other. Precisely, in a situation where auditors are interested in their personal benefits, with little concern for the clients, are they more inclined to pursue contending tactics? Inversely, when they are more concerned about their client's interest relatively to their own interest are they more inclined to pursue conceding tactics (Fu et al., 2011)?

At the bargaining power level, research finds that auditors are more inclined to use competitive strategies when their bargaining power is important (Brown and Wright, 2008). In this thesis, I propose the negotiation strategies choice and the auditor acceptance of management's position will be influenced by the motivational factors, i.e. engagement risk and client pressure and bargaining power i.e. corporate mechanisms strength. This proposition builds upon theoretical and empirical work that proposes that these variables influence the negotiation strategies and the proposed adjustment (Hatfield et al., 2008; Agoglia et al., 2011; Brown-Liburd and Wright, 2011).

Auditors rely on perceptual lens that helps them assess the situation in which they exercise the audit task. Therefore, audit judgement cannot be reduced to the use of the available financial information. Recent theoretical and empirical research reveals that other factors related to the accounting and auditing environment, to individuals abilities and to parties relationship may impact on the decision making process of auditors (Beattie et al., 2000; Brown-Liburd and Wright, 2011).

Engagement risk perception influences directly the auditor's self-interest. It is then expected that such perception will elicit or reinforce auditor's competitive behaviour according to the economic perspective. However, according to motivation reasoning perspective, this impact is not straightforward as this could lead to conciliatory behaviour (Brown and Johnstone, 2009).

Furthermore, given their concerns for maintaining their job, auditors who are dealing with client pressure will be more concerned about satisfying their clients' needs such as their objective of hitting income thresholds. Consequently, the likelihood of conceding to their clients' wishes is important in this situation. However, professionals highlight that auditors are trained to withstand client pressure and that waiving the proposed adjustments are considered to be inappropriate and unprofessional (Ng and Tan, 2003; Bame-Aldred and Kida, 2007). Therefore, auditors' concession strategy is not expected.

Another important determinant of auditors' negotiation strategies is bargaining power (Gibbins et al., 2001) which is defined as the auditor's perceived possibility of success in negotiation (Gibbins et al., 2001). In this context, when auditors perceive themselves as more powerful, they require more conservative accounting treatments. Overall, auditors who seek to enhance their power must consider that power depends on factors

related to the environment in which they operate their abilities and those of their counterparts.

It is because negotiations are considered a decision making process in which different pathways can be used; the Throughput model is particularly relevant to our understanding of auditors' negotiation approach. This model highlights that auditors should take not only the issue at hand and the financial information into consideration when they chose a strategy for negotiating contentious accounting issues, but rather they should incorporate the perception of the auditing environment. Moreover, this model suggests that not only the elements of the decision making process are important, the sequence of these components and the way they interact are also important for understanding the negotiation process.

In summary, given that negotiation is a decision making process where different weights can be put on different components of this process; auditors can use different pathways in order to formulate a decision related to their negotiation approach. Given that contextual features are part of the auditor's perception, we propose that negotiation can be better viewed through the throughput model lens.

1.3 Research Questions

The central theme of the thesis is to develop and test theory about how auditors' motivational factors and bargaining power influence auditors' negotiation strategies.

With that goal in mind, I now present the research questions.

1.3.1 The effects of engagement risk perception on auditor's adjustments and negotiation strategies

It is widely recognised that engagement risk perception has a significant impact on auditor's accounting adjustment and negotiation strategies choice (Johnstone, 2000; Brown and Johnstone, 2009). Auditors determine the required amount to be adjusted from a set of acceptable alternatives. This preference depends on the engagement risk perception related to the client company (Brown and Johnstone, 2009; Sahnoun and Zarai, 2009). Moreover, it is expected that the engagement risk perception to be influenced by financial information (St. Pierre and Anderson, 1984; Schipper, 1991; Stice, 1991). If auditors perceive engagement risk to be high they may be more likely to reject client's accounting alternative. However, according to motivating reasoning, they might be induced to accept their client's proposition and look for justification that is consistent with the client's wishes (Brown and Johnstone, 2009).

In order to pursue this objective, auditors will select negotiation strategies that are consistent with the objective mentioned above. This means, that conceding strategies will be preferred when there is greater acceptance of client's preferred outcome, and contending strategies when there is less acceptance. It is also worth considering the use of other strategies i.e. compromising and integrative strategies. Therefore, the first question is:

Research question 1: How does engagement risk perception affect auditors' negotiation strategies?

A key to understanding the mechanisms by which auditors decide on the way they will pursue negotiation approach is understanding the pathways they use, particularly the

Throughput model theory suggests that financial information and perception –which are interrelated- lead to judgement in a first stage, then in a second stage both the perception and judgement influence decision choice. This suggests that financial information influences engagement risk perception in a first stage, which affects auditor proposed adjustments, then in a second stage judgement and perception influence auditors' negotiation choice. The second question, therefore, is:

Research question 2: How does engagement risk affect the pathways used by auditors when they decide about negotiation strategies?

It has to be noted that the perception of client risk can change over the course of the audit as the compliance tests and tests of detail are undertaken. However, the scope of this research is restricted to the perception of client risk at the planning stage.

1.3.2 The role of client pressure

Audit research suggests that auditors respond to client pressure by conceding to client wishes. This will be reflected in accepting their aggressive accounting treatment (Hatfield et al., 2008; Hatfield et al., 2011). Indeed, given the increased competition auditors need to maintain positive relationship with the clients necessary for their survival. However, this positive relationship could also be achieved by other means, such as compromising, which consists of making small concessions in order to make the other party concede. This is more likely to happen, especially considering that, auditors are trained to be covered against client pressure (Knechel and Vanstraelen, 2007) and that conceding to client pressure is seen as unprofessional (Ng and Tan, 2003). Therefore, it is worth examining the effect of client pressure on auditors' negotiation strategies.

Research question 3: How does the client pressure affect negotiation strategies?

It is important to study the way client pressure affect negotiation strategies, the different components and their relative weights in the decision making process of auditors when they chose their negotiation strategies. This leads to the fourth research question:

Research question 4: How does client pressure affect the pathways used by auditors when they decide about negotiation strategies?

1.3.3 The role of the audit committee

Another goal of this study is to examine in more depth how the bargaining power influences auditors' negotiation strategies. The approach of the experimental study is to vary bargaining power perception by varying the corporate governance mechanisms strength (specifically the audit committee); since corporate governance strength presents ammunition against client pressure.

Research finds that the presence of a strong audit committee can motivate negotiators to behave competitively (Ng and Tan, 2003). Although the audit committee appears to play a hybrid role that falls somewhere between a mediator which consists of assisting both parties in their negotiation and an arbitrator which consists of deciding who wins in the course of negotiation, the research noted above implies that accountability pressure from the audit committee can influence auditors' behaviour.

Audit committee performance has been given a new role by regulations reforms (SOX, 2002). In fact, they are now responsible for hiring auditors, and more involved in auditor-client disagreements (Gibbins and Jamal, 2005; Cohen et al., 2007). However, the effect of the audit committee in auditor-client negotiation depends on its efficiency, and this means that not only its presence can influence auditors' negotiation approach. For instance, audit committees members who are financial experts and who are constantly asking for justifications for accounting and audit standards adoption (Cohen

et al., 2007), will be viewed as more cooperative by auditors when they want to withstand aggressive client management reporting choices. Given that the efficiency of the audit committee increases the perception of auditors about the extent of being supported in disputes with client management, we posit the fifth research question as follows:

Research Question 5: How does the efficiency of the audit committee affect auditors' negotiation strategies?

Finally, it is important to study the way the audit committee affect negotiation strategies, the different components and their relative weights in the decision making process of auditors when they chose their negotiation strategies. This leads to the final research question:

Research question 6: How does the audit committee influence the pathways used by auditors when they decide about negotiation strategies?

1.4 Research Contributions

The generic negotiation literature emphasizes the impact of framing, which is the way a problem is described or perceived. Raiffa (1982) suggests that the way a question is posed can cause certain evaluative objectives to be perceived as significant and thereby influence the outcome. This suggests that in an auditor-client negotiation context, the auditors' perception of contextual features plays an important role in the decision process. The Throughput model utilised in this research describes the auditors' decision-making process when they collect and treat perception of audit environmental characteristics. This method extends traditional decision-making models, which view that auditors process information passively. The Throughput model depicts the way auditors operate when they receive facts about the negotiation.

This study will expand the auditor-client negotiation research by modelling the decision making process of auditor when they chose negotiation strategies. Particularly, the Throughput model, which will be tested in the current research, suggests that auditors use the information and perception of their contextual features to analyse in the judgment stage in order to formulate the decisions concerning the negotiation strategies.

Researchers have identified different negotiation strategies employed by auditors like concessionary, contending, compromising, problem solving and expanding the agenda of issues (see Brown and Wright (2008) and Salterio (2012) for a review) and also examined factors that influence auditor choice of negotiating strategies. However, none of these studies have attempted to model the key factors to examine how they work in the decision process. This study explores the impact of motivational factors (i.e. the effect of the engagement risk and client pressure) and auditor bargaining power (i.e. the effect of audit committee strength) along with financial information on auditor negotiation strategies. Thus, the study extends the auditor client negotiation literature by modelling the auditor decision process for selecting negotiation strategies.

Moreover, this research attempts to understand the possible effects of the concern of self-interest and the concern for others on one hand and the effect of the bargaining power on the other. In addition it adds to the survey studies (Gibbins et al., 2001; Beattie et al., 2004) and experimental research (Ng and Tan, 2003; Trotman et al., 2005) by modelling a larger negotiation setting.

Previous findings on the influences of engagement risk on auditor negotiation behaviour are mixed and more research is needed to understand the effect of engagement risk in negotiations. In this study, I will examine whether engagement risk is related to auditor's required adjustment and to auditors' approaches toward negotiation. This will

provide confirmatory evidence of the effect of engagement risk relying on the motivation-reasoning lens. It will also extend current literature by examining all the negotiation strategies set available for the auditor and not just the extent of conceding.

More knowledge on what is going on inside the “black box” is fundamental for the audit process improvement; this enables regulators to set rules and mechanisms that target the deficiency of the audit process. In addition, it enables audit firms to better allocate their staff depending on the engagement characteristics. In this light, investigating the role of the client pressure and bargaining power (i.e. audit committee strength), enables us to assess the adequacy of Sarbanes- Oxley (SOX) regulatory reforms.

This study will provide valuable information about the way auditors behave in negotiation. This can be reflected in training programs in order to prevent auditors’ conciliatory behavior with regard to aggressive accounting treatments.

The majority of the research undertaken on auditor-client negotiation uses analysis of variance. However, my research uses technique analysis consisting of structural equation modeling. In fact, auditing research highlighted that constructs, such as engagement risk, client pressure and bargaining power, are complex in nature and that participants may have different interpretations of these constructs. Therefore, using partial least square modeling will allow incorporating each participant’s assessment of the constructs used in the experiment. To our knowledge, only Sahnoun and Zarai (2009); Gibbins et al. (2010) and Koch and Salterio (2017) have used this technique. They used precisely Covariate Based Structural Equation Modelling (CB-SEM); we will use partial least square-SEM, the alternative approach to CB-SEM, which is particularly appropriate where the theory is less developed. Further, this technique has

been selected since it allows incorporating formative latent constructs and single item constructs. I will explain this difference later in chapter 6.

1.5 Research Methodology overview

To achieve the aim and objectives of this study, an experiment has been conducted to identify the effect of the engagement risk, client pressure and corporate governance mechanisms strength on auditors' choice negotiation strategies. Participants were professional students with auditing and accounting work experience in the USA. Partial Least Squares Structural Equation Modelling (PLS-SEM) has been adopted as the main analysis technique to test the theoretical model.

1.6 Structure of the Thesis

This chapter has presented the research conceptual foundation, research questions, research significance and contributions. The remainder of this thesis is structured as follows:

Chapter 2 will explain the literature relating to generic negotiation research. This will be discussed in the light of the most common ways of classifying negotiation research. It will then present auditor-client negotiation research focusing on the main concepts and assumptions. Once this is established, this chapter will provide a detailed literature review of auditor client- negotiation research and finish by focusing on negotiation strategies. Chapter 3 will explain how conflict of interests is linked to negotiation and provides a detailed explanation of what bargaining power is.

Chapter 4 will explain the decision-making process of auditors drawing on the premise of throughput model theory to develop a theoretical model of how auditors make decision about their negotiation strategies. The theoretical model aims to operationally

define what would represent the perception dimension, information, judgement and decision in this decision making process and to present the potential pathways auditors use to formulate their decision choice. Based on the theoretical model, the study hypotheses will be generated and presented in Chapter 5.

Chapter 6 will discuss different research paradigms and methodologies and presents the rationale behind using a positivist approach. Main data collection methods will be presented which will illustrate the appropriateness of using an experiment in order to test the research hypothesis. Finally, this chapter presents the analytical and statistical techniques adopted by this research. Finally, it ends with illustrating the experiment case used to validate empirically the research questions, presents the measurement model, and specifies the research latent constructs.

Chapter 7 will explain the evaluation procedures of the measurement model to ensure reliability and validity of the research constructs. This chapter will also present descriptive statistics related to demographics characteristics of participants and those of the research constructs. This will be followed by assessing the structural model, testing the research hypotheses and discussing the research findings in Chapter 8. Chapter 9 will summarize this research and provides research contribution as well as the limitations and future research opportunities.

Chapter 2: Literature review

2.1 Introduction

The purpose of this chapter is to present the keys concepts of negotiation research, to provide an overview of prior research including generic negotiation research and auditor-client negotiation research, to identify important findings of previous studies and to provide the background for the theoretical arguments that will be used for hypothesis development.

In this chapter, I first start with an overview of generic negotiation research and present two main negotiation typologies. I present then the definitions of negotiations that are used in prior research and discuss important features of auditor-client negotiations. I present and discuss prior research that is relevant for the topic of this thesis and links the literature to Gibbins et al. (2001) Model. In section 2.6, I present different types of negotiations. This knowledge is used in chapter 5 to develop hypotheses. The section also emphasizes that all negotiations strategies are similar to generic negotiation strategies and that these depends on the degree of self- interest and concern for others.

2.2 Generic negotiation research: an overview

Murnighan and Bazerman (1990) consider negotiation any situation where two or more actors having different preferences make joint decisions that have consequences on the wealth of all the participants. Furthermore, according to Pruitt and Carnevale (1993) negotiation is mainly an interaction between two or several actors who want to resolve disagreements caused by conflicts of interests.

Despite the variety of negotiation definitions, researchers share common concepts around negotiation, most importantly all the theories consider that actors believe that

negotiation allows them to realise better outcomes. Theorists do not have a consensus on the question of how to categorise the main schools of thought in negotiation. Therefore, there have been different ways of classifying negotiation research. The simplest approach is to classify the research based on scientific disciplines (e.g. communication, economics, psychology, etc.). This resulted in diverse negotiation approaches reflecting the diversity of the disciplines they are driven from and an advanced knowledge of the negotiation process. However, researchers presented a more advanced classification such as Raiffa et al. (2002) who argue that negotiation approaches can be grouped into 4 main categories: Decision analysis, behavioral decision making, game theory and negotiation analysis. Furthermore, Zartman (1988) classified negotiation into five approaches; these are structural, strategic, behavioral, concession and integrative (Zartman, 1988). The purpose of this section is to present an overview of the above-mentioned classifications.

2.2.1 Raiffa et al. (2002) typology

According to Raiffa et al. (2002) negotiation approaches can be grouped into four different categories: Decision analysis, behavioral decision making, game theory and negotiation analysis.

2.2.1.1 Decision analysis.

This approach investigates the way rational individuals are expected to make decision (Raiffa et al., 2002). Fundamentally, under this approach the authors assume that parties are rational in their decision-making process.

2.2.2.2 Behavioural decision-making.

This approach highlights actors' psychology in the decision making process (Raiffa et al., 2002). Behavioural decision making theorists suggest that individuals are not always expert in negotiation (Rubin and Sander, 1991) and that negotiation always contains deviations and behavioral errors, thus they suggest that researchers should investigate these anomalies in order to better understand negotiation (Raiffa et al., 2002).

2.2.2.3 Game Theory.

This approach investigates how individuals should act considering the payoffs of all the actors in the negotiation (Raiffa et al., 2002). Game theory researchers investigate the decision-making process of negotiators and their underlying actions. It is worth noting, that negotiation is based on the assumption that negotiating parties are perfectly rational which represents the main criticism of this approach (Siebe, 1991; Sebenius, 1992).

2.2.2.4 Negotiation analysis.

This approach investigates how negotiators collaborate when they make joint decisions (Raiffa et al., 2002). This approach tries mainly to predict one party's behavior given its counterpart's actions. Furthermore, this approach is concerned with the influence of perception in negotiation (Sebenius, 1991).

Table 1 below provide a summary for basic features, assumptions and limitations of Raiffa, Richardson and Meltcalfe approaches.

Table 1 Summary of Raiffa et al. (2002) approaches

Approach	Basic Features	Assumptions	Limitations
Decision analysis	How an analytically inclined individual <i>should</i> and <i>could</i> make wise decisions?	Rational individuals	Negotiators may not always rational
Behavioral decision making	Focus on the psychology of individuals	Negotiation can be improved by understanding anomalies and deviations which occur in negotiation	Lock into psychological factors.
Game Theory	How individuals <i>should behave</i> when their separate choices interact to produce payoffs to each player?	Full game-theoretical rationality in negotiations	Negotiators may not always be rational
Negotiation analysis	How groups of individuals <i>should</i> and <i>could</i> make decisions based on how the other party will behave?	Different modes of perception of negotiators	Emphasis of the other party's reaction.

Source: The Author

2.2.2 Zartman (1988) approaches

Zartman (1988) have presented five approaches of negotiation strategies; these are the structural, the strategic, the process, the behavioral and the integrative approaches.

2.2.2.1 Structural approach

Under structural approaches, the realized outcomes depend on the specific structural characteristics of the negotiation, which includes for instance the characteristics of individuals participating in the negotiation (e.g., individuals' power, structural approaches assume that negotiation outcome can be predicted once the structural features are known). According to Bacharach and Lawler (1981), power is the most

important factor that influences negotiation. In other words, the more parties possess relative power over their counterparts, the more they realize their preferred outcome. In the light of this, power is defined as the probability of individuals to succeed in taking up the biggest part of available resources in the negotiation. The over emphasis of structural approaches on power has been considered as a major limitation, as they focus on the position that parties may take and neglect their interests. Moreover, the conceptions of structural approaches assess the performance of negotiators by their power use even if it has negative consequences for their future negotiation.

2.2.2.2 Strategic approach

Strategic approaches to negotiation are driven from different disciplines, mainly from decision theory and rational choice theory. Moreover, they take advantages from different developments of conflict analysis. They are considered as the foundation of game theory and critical risk theory.

The difference between structural approaches and strategic approaches is that the former focus on the influence of objectives (goals) on the outcomes, whereas structural approaches focus on the role of power as discussed earlier. Strategic approaches are considered mainly as rational choice models where parties are considered rational in their decision-making process that assesses each alternative considering the benefits and the costs of each alternative and chose the most advantageous one. Further, these models assume that a large set of alternatives available to negotiators who try to choose the best option possible taking into consideration the associated costs of each alternative. Strategic models have been criticized because they consider that every negotiation has a unique optimal solution. Precisely, they look for Precisely, they look for how rational individuals act in highly competitive bargaining context (Raiffa, 1982).

2.2.2.3 Behavioural approach

Behavioral approaches focus on the influence of the actors' characteristics such as personality's traits and individual's skills and abilities on the negotiation process.

While strategic approaches underweight the role of individuals, the behavioral approaches consider this as an essential element determining the course of negotiation. This includes the persuasion techniques that negotiators use to take the advantage over their counterparts, the effect of perception and personal incentives in the negotiation. The influence of individuals on negotiation has been validated by experimental research; precisely individuals' motivation has two main dimensions: the extent of importance given to interpersonal relationship and to the negotiation outcomes. This results in four personal motivation types: the individualistic, the altruistic, the cooperative and the competitive.

According to the individualistic approach, negotiators are concerned about their self-interest. Conversely, negotiators in altruistic approaches are more concerned about others' interest. When considering the cooperative approach, individuals are concerned about their self-interest as well as for the interest of their counterparts. Finally, individuals in the competitive approach are concerned to take advantages over their counterparts.

Besides their contribution on the influence of personal motivation on negotiation, behavioral approaches contribute on the impact of framing on the negotiation, which involves how negotiators perceive a specific issue and its related context. They argue that differences in perception affect the negotiation outcome (Raiffa, 1982). Further, Neale and Bazerman (1991) found that the way of a disagreement is presented

influences the objective of negotiators, e.g. maximization of the profit or minimization of the loss and the success of negotiation in resolving the disagreement.

2.2.2.4 Concession exchange approach

Concession approach views negotiation as process in which negotiators learn how to respond to their counterparts concession strategies (Zartman, 1978). This approach benefits from the structural approach, specifically its power dimension. In addition, it benefits from the strategic approach and its underlying concept of outcome.

Parties use their proposed offer as a response to the other party offer and as a tool to influence the next offer. As a result, the offers represent a manifestation of power (Zartman, 1978). Therefore, actors use concessions in order to show their cooperation to their counterparts and to make them more flexible. It is worth noting that people pursuing this approach may miss opportunities gained by new solutions.

2.2.2.5 Integrative approach

Integrative approaches view negotiations as a game with win-win outcomes. This is possible by looking for creative alternatives that allow both parties to win. Therefore, it is essential to share information between parties (Lewicki et al., 2003). These approaches require more effort from both parties as they imply serving mutual benefits by producing a large number of alternatives in order to make the common possible options between parties wider.

“Phase” theories are examples of theories under the integrative approaches, which consider negotiations as a process of multiples phases, namely diagnostic phase and details phase (Zartman and Berman, 1982).

Table 2 Summary of negotiation approaches

Approach	Basic Features	Assumptions	Limitations
Structural	Focus on means, positions and power	Win-Lose	Lock into positions might lead to lost opportunity for mutually beneficial agreement. Over-emphasis on power
Strategic (Game theory)	Focus on ends, rationality, positions	Win-Lose, existence of optimal solutions and rationality of players	Excludes use of power, players undifferentiated (apart from differences in the quality of options open to each)
Behavioral	Focus on personality traits	Win-Lose, role of perceptions and expectations	Emphasis on positions
Concession exchange	Focus on concession making behavior, positions	Win-Lose, moves as learned (reactive) responses	Emphasis on positions Lack of predictiveness
Integrative	Focus on problem solving, creating value, communicating, win-win solutions.	Win-Win potential	Win-Win potential

Source: The Author

2.3 Auditor-Client negotiations

According to Murnighan and Bazerman (1990), negotiation involves situations where different parties having different preferences make decisions that influence the interest of all the parties. Several insights could be drawn from this definition: to start with (i) Auditor and client must argue about the appropriate treatment. (ii) the negotiation

affects the welfare of both the auditor and the client. (iii) only joint decisions are considered as a part of negotiation, one- sided actions before the issue is raised, for instance when the auditor waive the audit differences without informing the client, are not part of the negotiation (Salterio, 2012).

Gibbins et al. (2001) have built a negotiation model using the work of Neale and Bazerman (1991), which is in turn based on Walton and McKersie (1965)'s work. This model supposes that the auditor is the initiator of the negotiation and triggered by client retention incentives, engagement risk, accounting standards implementation, etc.

The process starts with the identification of an accounting issue that the auditor must resolve with the client. S/he then identifies the range of acceptable financial treatments and her/his most preferred position. On the other hand, s/he also identifies the client's range of acceptable financial positions and her/his most desired position. Furthermore, it has to be noted that the auditor's and the client's acceptable range can overlap or be separate, and the most preferred position of both parties can be within or outside the acceptable range of each other.

In the Gibbins–Salterio model, the client's and the auditor initial positions are presented by their preferred financial statements, which depend on their perceptions of the accounting context and their motivations. These preferences are identified by the information available to both parties when the judgement is made. Further, the auditor builds knowledge about the negotiation situation as the negotiation progress. Figure 2 below illustrates Gibbins et al. (2001) model.

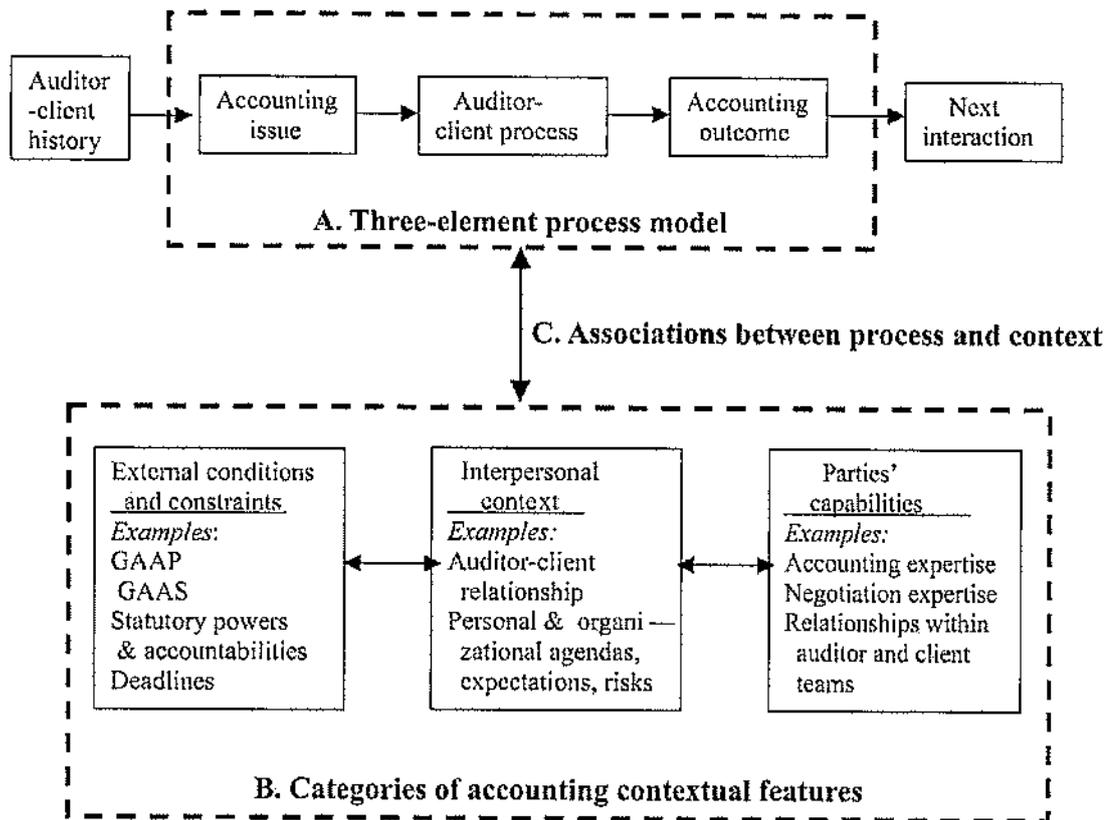


Figure 2 Auditor-client negotiation model

Source: Gibbins et al. (2001:537) "Evidence About Auditor-Client Management Negotiation Concerning Client's Financial". *Journal of Accounting Research*

In a structured research interviews Gibbins et al. (2001)'s audit partners and Gibbins et al. (2007)'s CFOs were invited to evaluate the order of importance of the process elements and the contextual features. The studies suggest that negotiation is common practice in auditing, all participants reported they have experienced negotiations and they also reported that the negotiation was distributive (win-loss). In addition, most of the negotiation involves complex accounting issues mainly; this is reflected in the fact that a large number of participants takes considerable time in negotiation. Finally, auditor expertise was considered as essential in auditor-client negotiation. Furthermore, their findings show that accounting and disclosure standards on one hand, and audit

firm's negotiation expertise on the other hand were rated as the most important contextual features by participants.

Gibbins et al. (2001) group auditor-client negotiation contextual features fall into three groups. First, the primarily external group includes elements that are not under the direct control of either party such as accounting standards, deadlines, audit committee; second the primarily interpersonal factors which concern the roles of key players in both organizations and their desires about how to develop relationships and manage them. Finally, the primarily capabilities group refers to the set of expertise, knowledge and skills that each party bring to the negotiation and each party's perceptions of the other side's expertise, knowledge and skills.

Beattie et al. (2004) have proposed a different model for auditor-client negotiations using matching interviews with audit partners and CFO from UK companies. The findings identified six different context variables mainly audit partners' integrity level, the type and situation of the company, the effectiveness of corporate governance mechanisms; the clarity of accounting rules on the issue, the level of audit firm support and control and the quality of the primary relationship between the client and the auditors.

Despite their importance, the accounting and auditing standards didn't seem to have an impact on the negotiation process elements (Gibbins et al., 2001). Further from the CFO perspective, the negotiation objective aimed for compliance with the accounting rules rather than the economic representation situation (Gibbins et al., 2007). On the other hand Beattie et al. (2004) suggest that the clarity of accounting rules has an influence on negotiation outcomes.

While the integrity and the strength of corporate governance mechanisms are considered to be essential in the auditor-client negotiations context by Beattie et al. (2004), Gibbins et al. (2001) find that the audit committee has little impact on auditor-client negotiations.

2.4 Research on Auditor-Client negotiation: Literature Synthesis

In this synthesis, we include research literature that deals with auditor-client negotiation and we provide insights regarding the dynamics of negotiation in the auditing context. Our examination of extant literature discusses the determinants identified by researchers that have an impact in auditor-client negotiation. As discussed previously, Gibbins et al. (2001) presented a seminal paper, which provides a comprehensive model of auditor-client negotiation. I consider the Gibbins and colleagues' Model in my review and synthesis of literature on auditor client negotiation; therefore, I group antecedents into three subcategories: external conditions and constraints, parties' capabilities and interpersonal context.

An auditor may have the required knowledge, experience, or traits that enable her/him to identify a misstatement. However, s/he may decide not to require the adjustment because of the different pressures in the specific context related to the environment or to the client characteristics. Similarly, the auditing environment may encourage the auditor to require the adjustments (e.g. high engagement risk), but the auditor fails to persuade the client of adjusting the audit difference because s/he lacks the knowledge or the experience in negotiation. The Gibbins's Model is especially insightful when examining the factors that affect auditor-client negotiation because it considers the potential interactions between parties' characteristics such as knowledge, experience, and ability; environmental characteristics such as engagement risk, nature of the accounting

standards and combines them with the characteristics of the role the auditor-client relationship to explain the negotiation performance and outcomes.

2.4.1 Parties' capabilities

2.4.1.1 Experience and expertise

This line of research examines the role that experience plays in improving the negotiation performance and outcomes. Experience allows auditors to develop the necessary knowledge that will enable them to determine the appropriate amount to be recorded and therefore negotiated. Experience has been examined in terms of general audit and accounting experience (i.e. number of years as an auditor), industry specific experience, negotiation experience and training.

Negotiation experience

The generic negotiation literature suggests that negotiation experience enhances negotiator's performance and consequently the achieved outcomes (i.e., (Rubin and Brown, 1975; Bartos, 1977; Neale and Northcraft, 1986; Montgomery and Benedict, 1989) Johnstone and Muzatko (2002) and Brown and Johnstone (2009) confirmed this evidence in an audit context. Specifically, they find that more experienced auditors are more able to develop a wider range of alternatives, notably with risky clients, in comparison to those with less experience. Moreover, the alternative set of the latter has been reported to be considerably affected by management client's preferred alternative, which may influence the quality of resulting financial statements. Therefore, they concluded that providing training to auditors might be beneficial for financial reporting quality.

In the same context, Brown and Johnstone (2009) have associated auditors with different negotiation experience to a computer-simulated client to study the effect of

negotiation experience on the concessions offered to clients. Their findings provide evidence that less negotiation experience leads to a greater concession to the client's preferred method when the engagement risk is important, compared to more experienced auditors, which are found to be more resistant to the client's preferred method, thereby they do not depart from their initial position irrespective of the company's engagement risk. Similarly, Sahnoun (2011) has found a positive and significant relationship between auditor experience and the extent to which the auditee agreed with the auditor over the financial reporting issues.

Fu et al. (2011) argue that the auditor's negotiation experience influences the effect of client negotiation style on auditors' perceived negotiation outcome, specifically when the negotiation style of clients is contentious, auditor's negotiation experience allows higher outcome (more conservative asset write down), however the negotiation experience does not affect negotiation outcomes when the negotiation style is collaborative.

Experience and knowledge developed from prior negotiations improve negotiation skills (Druckman, 1968; Thompson, 1990). In this context, Gibbins et al. (2001) argue that auditor-client negotiation often involves several consecutive periods. Therefore, auditors build knowledge about the way clients negotiate which allows them to gain an advantage over the client.

The increased complexity of accounting issues results in a wide range of acceptable options. In order to resolve contentious issues, auditors seek and rely on the opinions of consultations units within the audit firm when selecting among the best alternative to be recorded. However, these consultation units generally provide solutions, which are in line with client's preferences (Salterio, 1996); this makes the auditor rely on biased

advice. In this context, auditors' experience and negotiation experience mitigate considerably this risk (Rubin and Brown, 1975; Bartos, 1977; Neale and Northcraft, 1986; Montgomery and Benedict, 1989). According to Davis and Solomon (1989) and Davis and Solomon (1989), cumulated years of experience do not necessarily result in task experience.

Audit rank

Scholars have suggested that audit quality might be improved by involving more senior auditors in the auditing process, as they are supposed to have a better understanding and proficiency of the audit task. In fact, they are found to perform better in persuading the clients with their preferred alternative. On the other hand, researchers have raised concerns about the ability of less experienced auditors to effectively negotiate with the client and therefore require making the necessary adjustments. For instance, Trotman et al. (2009) demonstrate that audit partners required a higher amount for the initial write-downs and average amount for the minimum write-down as compared to audit managers. Moreover, the ultimate inventory write-down required by the client was larger for audit partners as compared to audit managers. However, this study did not prove any difference in negotiation persuasion skills between audit partners and audit managers.

Specific industry experience

It has been evidenced that industry expertise improves auditor performance in general which means that the audit quality is improved when the auditor is a specialist in a given industry (Moroney, 2007). Archival research investigating the impact of industry expertise supports the findings that industry expertise is positively associated with audit quality (Low, 2004; Romanus et al., 2008) and earnings quality (Balsam et al.,

2003; Low, 2004). For instance, industry specialist auditors perform better in detecting earnings management (Krishnan, 2003), assess inherent risks more effectively (Taylor, 2000), and assess audit risk more accurately (Low, 2004).

For example Brewster (2012) shows that auditors with a better knowledge of the client's industry are reported to be less influenced by the persuasion tactics used by the clients and require larger audit adjustments. Similarly, Sahnoun (2011) has addressed this issue using Tunisian companies; however, they have found a positive but non-significant relationship between the auditor industry specialism and the negotiation outcome.

Accounting firms are organized according to industry lines. Further, they use industry specialization as a competitive edge to stay ahead of the competition (Hogan and Jeter, 1999; Francis and Schipper, 1999). Research examining the effects of industry expertise aims to understand how audit firm specialization affects negotiation performance and outcomes. However, if an audit firm is beholden to a particular result, it may become less objective and independent (Gramling and Stone, 2001). This is explained by the fact that auditors want to preserve their clients in the industry to maintain competitiveness within the industry and therefore they concede to their wishes.

Training

The current practice of focusing essentially on training auditors by cumulating job experience may not be sufficient in improving their negotiation performance. For this reason, researchers suggest that auditors should be trained to be conscious of their decision-making processes. More specifically, they need to be aware of the common unconscious biases that may affect their judgments. This will help auditors to resist client persuasion attempts. In this light, Bazerman et al. (2002:102) suggest, "what's

needed is education that helps auditors understand the unconscious errors they make and the reasons they make them. That knowledge alone will not solve the problem, but once members of the auditing profession understand the role of bias in their work, honest and visionary leaders in the profession can help change the conduct of accounting to prevent the conflicts of interest that promote bias.” Auditors can be trained through active and explicit simulation of the client's situation. For instance, when auditors are invited to assume their client's role ("role-playing") before the actual negotiation takes place and recognize the client's needs in a mock negotiation, greater advantages are achieved specifically, they were more satisfied with the negotiation, the information was exchanged efficiently which results in higher financial reporting quality (Trotman et al., 2005). Furthermore, role-playing results in improved negotiation outcomes compared to the outcome achieved through simply and passively taking into account the client's position. Importantly, in the above-mentioned study, audit managers and partners actually negotiated with another person assuming the client's position.

In conclusion, the effects of experience on auditor client negotiation is explained by various factors, for instance the level of understanding the client's business and industry, years of auditing experience, negotiation experience and training. Most importantly, the finding that negotiation experience improves negotiation performance and thereby the outcomes suggest that providing students and auditors with experiential learning in negotiation may lead to better-negotiated outcomes.

2.4.1.2 Persuasion tactics

Perreault and Kida (2011) have investigated the impact of persuasion tactics in auditor-client negotiation. Particularly, they studied four persuasive tactics used by auditors to get their position accepted by the client in auditor-client negotiations arguments i.e.

threatening to qualify the audit opinion, warning of the possibility of a quality control review, soliciting the opinion of a technical expert and describing how other companies have handled similar accounting issues. Moreover, they studied whether the way of communicating the arguments enhances the negotiation outcome; their findings provide support of the effectiveness of the type of persuasion tactic on the concessions offered by the clients. Precisely, the authors find that, although, using the audit opinion qualification threat leads to significant client concessions. A tactic of just informing the client that other companies have resolved the accounting issue in a similar way to that proposed by the auditor is just as efficient, or even more efficient than other tactics used to obtain significant concessions from the clients. This technique also allows the development of positive affect towards the auditor.

On the other hand, the authors find that the propensity of clients using concessions strategies is more likely to lead to a better appreciation of auditor by the clients who are more satisfied with the negotiation outcome when the arguments are communicated using a cooperative, rather than contentious communication style. These findings highlighted the benefits of the training in persuasion tactics can have in auditor-client negotiation. It particularly enables better negotiation outcomes and develops positive relationships with clients.

2.4.1.3 Professional skepticism

Professional skepticism may induce auditors to be more vigilant and therefore reject aggressive client's financial alternatives. This may result in a conflict between auditor and clients concerning contentious accounting issues which, may involve negotiation between the auditor and the client before agreeing on the appropriate accounting treatment.

Brown-Liburd et al. (2013) investigated the impact of professional skepticism and management's incentives in the negotiation process. Their results indicate that lack of professional skepticism is associated with greater concessions offered to the clients and with more aggressive reporting choices. Specifically, when there are incentives of earnings management to meet EPS target. These results reinforce prior research that suggests that professional skepticism is an important factor in all aspects of the audit process including the negotiation stage (Nelson, 2009; Hurtt, 2010; Quadackers et al., 2009).

2.4.2 Interpersonal relationships

2.4.2.1 Auditor-client management relationship

Auditor-client relationship affects the likelihood of the client cooperating with the auditor and the extent s/he could be easily convinced by her/his stance. In this context, researchers suggest that negotiator's relationship determine the items to be negotiated, the duration of negotiation, the way negotiation is addressed e.g. strategies and tactics and the potential consequences (Pruitt and Carnevale, 1993; Poitras et al., 2003). This evidence was supported in an auditing context by Gibbins et al. (2001) and Gibbins et al. (2005) who found audit partners and CFOs considered their previous relationship with client's management as influential when they resolve contentious issues.

According to McCracken et al. (2008) the auditor-client relationship can be proactive or reactive. A reactive relationship is "where the CFO initiates consultations with the audit partner before transactions are undertaken or disclosures drafted to ensure that the financial statements are of high quality". While, a proactive relationship is where "the CFO views the financial statements as being "his" and does not typically consult the auditors regarding appropriate GAAP treatment. This approach results in the audit

partner not identifying issues until late in the audit, with the CFO strongly committed to his position and, thus, making the negotiations more difficult” (McCracken et al., 2008:363). With reactive relationships, the auditor is not confident about the client’s acceptance of her/his proposition. Most importantly, prior research has indicated that clients who are not satisfied with the negotiation outcome are more likely to suspend the relationship with the auditor (Sanchez et al., 2007; Tan and Trotman, 2010). This suggests that the contentious negotiation style results in the client being dissatisfied with auditors who require making audit adjustment, and therefore s/he is less likely to retain the auditor in the future.

An example of this would be the findings from Hatfield et al. (2008) that show that client negotiation style affects auditors’ extent of using a reciprocity-based strategy. They measure the use of a reciprocity-based strategy by the inconsequential audit adjustment considered in negotiation to waive them later rather than just waiving these inconsequential items without bringing them in the negotiation. Auditors believe that reciprocity based strategy makes the client reciprocate in turn and makes them more likely to concede to auditors’ propositions. The findings of this study indicate that auditors use more a reciprocity-based strategy when the client’s negotiation style is contentious and when there is a greater pressure of losing the client. However, results show that there is concession from the auditor both in terms of total items and in terms of the number of the significant items to be recorded, regardless of the client’s negotiation. In conclusion, client negotiation style affects the auditors’ use of a reciprocity-based strategy, but does not affect the negotiation outcome.

It has been argued that the effects of client negotiation style on auditors’ perceived negotiation outcome depends on other factors such as the auditors’ negotiation experience. In this context, Fu et al. (2011) found that when the negotiation style is

contentious, less experienced auditors negotiated lower write-down as compared when the negotiation style is collaborative. On the other hand, more experienced auditors are not influenced by the client negotiation style when they make judgement about the appropriate write-down to be recorded.

Negotiation with clients often involves multiple periods (Gibbins et al., 2001). Consequently, the nature of the relationship built between parties influences future negotiations. Furthermore, researchers suggest that negotiators operating in a continuous relationship context require more effort than those in single-period negotiations (Sheppard and Tuchinsky, 1996; Tenbrunsel et al., 1999). In this context, Brown-Liburd and Wright (2011) found that auditors insist more on making the adjustment when the past relationship with the CFO is contentious and when the audit committee is strong.

Gibbins et al. (2010) found that when the client relationship is positive and cordial, audit partners are more likely to use the “concede” strategy. However, they do not find support for the use of contentious strategy when the client relationship is negative and contentious. Furthermore, they found that audit partners are more committed to achieve the audit goal of reducing the net income when the relationship with the client is negative and contentious and when they are inflexible in their initial position.

2.4.2.2 Client pressure

Some evidence has been provided about the influence of client pressure in the auditor client negotiation process, and many accounting and auditing reforms have been implemented in order to improve the auditors’ propensity to stand tough in front of client pressure (Nelson, 2006). For example, Section 303 of SOX recommends to the Security Exchange Commission (SEC) to provide guidelines that minimise pressures

toward the auditor. The auditor's ability to resist client pressure is a major issue in the auditor- client negotiation context.

In fact, auditors' judgements can be influenced by client pressure, which induce auditors in motivation reasoning. This implies that they search for the evidence that is in line with a client desired outcome (Kunda, 1990). Furthermore, Kunda (1990: 493) notes that "directional goals have been shown to affect people's attitudes, beliefs and inferential strategies in a variety of domains and in studies conducted by numerous researchers in many paradigms." As such, economic incentives may lead auditors to set directional goals that are in line with the most preferred position of the client. In order to arrive to these conclusions, they need to find reasonable justifications for their choice.

The auditor-client negotiation literature states that when auditors are threatened to lose their job. (e.g. when the client is soliciting bids), the auditor may be induced to make more concessions since the client management has a strong negotiating position. In this context, Michener et al. (1975) and Hatfield et al. (2008) found that auditors use more reciprocity based strategy when client management style is competitive (high pressure) rather than collaborative (low pressure), and client retention risk is high. This strategy involves conceding immaterial elements in order to influence the client to concede in adjustments that are more material and leads to more conservative financial statements. Hatfield et al. (2010) found that auditors proposed smaller adjustments when client pressure was high (i.e. larger audit client that is opposed to making the full adjustment). Hatfield et al. (2011) have studied the impact of client pressure on audit adjustments, and they found that when there is high client pressure (e.g., when the client is soliciting bids for next year), auditors require smaller adjustments as compared to when they are

exposed to low pressure. Furthermore, the authors considered negotiation tactics used by auditors when the client pressure is high, the auditor may give a favorable opinion in order to keep the job, particularly when the client is putting pressure on them, which indicates a conceding strategy.

2.4.2.3 Reciprocity Based strategy

Negotiation theory advances that when actors inform their counterparts about the audit adjustment that they will waive, a more collaborative environment may be created, this will enhance the relationship between the negotiators and improve future negotiations (Putnam, 1990; Carnevale et al., 1992).

Sanchez et al. (2007) investigated, from both the client and auditor perspective, the impact of a concession strategy used by the auditor when they resolve accounting issues related to inconsequential items as compared to the impact of waiving these inconsequential items without informing the clients (i.e. a strategy of “no-concession”) involving the auditor insisting on its preferred position. The results show that auditor negotiation strategy has an effect on the way the negotiation issues are resolved. Precisely, client managers are more prepared to make significant adjustments when the auditor brings inconsequential items to the negotiation table and waives these items later (concession approach) as compared to the no concession approach.

Moreover, client managers are more satisfied with the auditor and their likelihood of recommending the retention of the auditor is higher when concession is used as compared to the non-concession approach. These results provide evidence that the concession approach increases the propensity of clients accepting the adjustment of significant items thereby improving the financial reporting quality.

On the other hand, the authors also investigated the efficacy of the concession approach from the point of view of auditor in a second experiment and find that auditors believe they should adapt their strategies according to the client's characteristics and depending on whether this facilitates recording the appropriate adjustments. Similarly, auditors have reported that they consider the concession approach results in higher client satisfaction and retention as compared to the no concession approach.

2.4.2.4 Timing of auditor concession

Choosing the right timing within a negotiation may have positive effect on auditor-client negotiation. In this context, Tan and Trotman (2010) state that an appropriate timing of using concessions allows auditors to achieve better outcomes. More precisely they find that the timing of the concession offered by the auditors influence client's judgements. Particularly gradual or late concessions results in the clients being more satisfied with the auditor's final offer and the negotiation outcome. Moreover, the auditor has higher chances of being retained by the client if s/he made early concessions. However, the client's satisfaction with the negotiation process does not seem to be influenced by the timing of the auditor's concessions.

2.4.3 External conditions and constraints

2.4.3.1 Engagement risk

Investigating the impact of the engagement risk in auditor-client negotiation is fundamental as engagement risk represents a remarkable characteristic of the auditing environment (Bell et al., 2002). It is precisely the "risk the audit firm is exposed to, and it involves the potential loss of, or injury to the professional practice from litigation, adverse publicity, or other events arising in connection with the audited financial statements" (Brown and Johnstone, 2009:78). Auditors understandably want to keep

this risk as low as possible, and the most effective way of doing this is by refusing to give in to clients' aggressive financial reporting attempts. The more conservative the financial statements endorsed by the auditors are, the lower their exposure to litigation or adverse publicity.

Hackenbrack and Nelson (1996) find that auditor's likelihood of accepting client's aggressive alternative is negatively correlated with the engagement risk. Similarly, Farmer et al. (1987) find that lower risk is positively associated with auditors' propensity of acceptance of aggressive reporting choices. Johnstone (2000) investigated the impact of engagement risk on the generation of financial reporting alternatives, and they found that higher risk results in a wider range of alternatives especially for knowledgeable auditors.

Brown and Johnstone (2009) find that the tendency of using concession strategies depends on negotiation experience and the engagement risk. Surprisingly, they found that negotiated outcomes are more consistent with client's preferences when the engagement risk is high for less experienced auditors. Moreover, the findings indicate that auditors are not very confident about the conformity of the negotiated outcome to generally accepted accounting principles (GAAP) as compared with both the less experienced auditors in the low-risk condition and the more experienced auditors regardless of the engagement risk condition. These findings provide strong evidence that engagement risk plays an important role in the auditor-client negotiation process and outcome.

2.4.3.2 Audit committee

Professional standards and regulators invite auditors to examine financial reporting quality with the audit committee (American Institute of Certified Public Accountant

“AICPA” 2000 and Blue Ribbon Committee “BRC” 1999), Moreover, Sarbanes-Oxley (U.S. House of Representatives 2002) has granted the audit committee additional power in the financial reporting process. In fact, the audit committee is now playing a significant role in overseeing the audit process and internal control. However, despite the increased power of the audit committee, the client and the auditor are still considered the major parties involved in the negotiation of contentious accounting issues (Cohen et al., 2007). Although not directly involved in the negotiation process, the audit committee is considered as an important ally for auditors in the negotiation process as it provides power to auditors when they negotiate with their client. It has to be noted that bargaining power is an important determinant in auditor- client negotiations (Gibbins et al., 2001). As such, there is evidence in the negotiation research that power assist negotiators in using contending strategy which will result in higher outcomes (Rubin and Brown, 1975; Greenhalgh et al., 1985). Thus, the strength of the audit committee is likely to influence the auditor’s bargaining power and therefore the achieved outcome.

Overall, the role of audit committee in mediating disputes between management and the auditor is important for financial reporting quality. Moreover, the impact of the audit committee in auditor-client negotiations depends considerably on the strength of the committee.

Ng and Tan (2003) offered the first study that has investigated the impact that the strength of the audit committee may have in auditor-client negotiations along with the availability of authoritative guidance. Their results indicate that the negotiation outcome depends on the availability of authoritative guidance and the strength of the audit committee. Precisely, auditors report that they believe the audit adjustment will be made in the clear accounting standards condition, even if this adjustment will result in missing

the analysts' forecasts, and regardless of the strength of the audit committee. On the other hand, when there is no clear authoritative guidance on specific accounting treatments, auditors believe that the audit adjustment will be only recorded when the audit committee is effective.

Brown-Liburd and Wright (2011) have supported this evidence. Particularly they found that auditors stand firm about their most preferred option in the case of a strong audit committee and contending relationship condition.

2.4.3.3 Firm Rotation

The Public Company Accounting Oversight Board (PCAOB) has raised concerns that long audit tenure may be a potential threat to independence and that imposing audit-firm rotation may help to tackle this problem. However, although the discussion over the advantages of audit firm rotation is not new, the majority of these studies considered audit tenure, and not audit firm rotation. In this light, experimental research by Dopuch et al. (2001) demonstrate that imposing audit firm rotation reduced auditors' propensity of biasing audit reports in favor of management. In the context, of auditor-client negotiation, Wang and Tuttle (2009) confirmed this evidence and report that participants are less willing to cooperate with the clients and that the negotiation outcomes are more consistent with auditor desired options when a rotation is imposed. An earlier study by Iyer and Rama (2004) investigated audit tenure as a part of four determinants in a single research, these factors were: auditor tenure, the importance of the client to the audit partner, non-audit service provided and the existence of former auditors in the client company personnel. The authors found evidence that CFOs report they are able to persuade the auditors of their alternative when the audit tenure is short. On the other hand, CFO participants believed that when the client is relatively important for the auditor, they are more able to persuade them of their alternative.

Although the aforementioned studies may provide some insight into the impact of audit firm rotation on auditor client negotiation, more research is warranted to investigate the effect of the audit firm rotation on the negotiation process, e.g. strategies pursued by auditors.

2.4.3.4 Audit difference magnitude

Although the auditor should be confident about the appropriateness of the accounting treatments, and his proposed adjustment should not be influenced by the magnitude of the audit difference, especially when the client management has incentives to bias financial reports in his favor, some evidence has suggested that auditors' proposed adjustments may be affected by the client's initial position. In this context, general negotiation literature states that initial position adopted by one party determines the counterpart's position (Pruitt, 1991). For instance, Pruitt and Drews (1969) demonstrate that 67 percent of the variance in future demands is explained by the initial position. Negotiators generally adapt their behaviours according to the other party opening move; this will guarantee the best outcome possible in negotiation (Rubin and Brown, 1975). Furthermore, Rubin and DiMatteo (1972) that, the expectations of negotiators are lower when the counterpart's initial position is high as compared to when it is low; this results in negotiators adopting positions close to their opposite party's positions.

In auditor-client negotiation setting, the client's initial position is represented by the unaudited account balances, which are expected to predict their attitudes and expectations about the negotiation, e.g. the propensity of concession and outcomes.

Hatfield et al. (2008) investigated whether auditors use a reciprocity-based strategy for the resolution of audit differences and what client characteristics (i.e. client management's negotiation style and client retention risk) increase the extent to which it

is used. However, Hatfield et al. (2008) results indicate that when the client's unaudited account balance diverges from the auditor's independent estimate account, the audit adjustments will deviate from auditor's estimate and converge with the client's estimate.

2.5 Negotiation strategies

Negotiations is "a process of potentially opportunistic interaction by which two or more parties, with some apparent conflict, seek to do better through jointly decided action than they could otherwise" (Lax and Sebenius, 1986:11). Negotiation strategies represent the way negotiators behave (Pruitt and Carnevale, 1993).

Negotiators will adopt the negotiation strategies that allow them to achieve the best possible negotiation outcome considering their goals and that of their counterparts. Furthermore, the existence of an overlap between parties' goals affects the negotiation strategies choice.

It is worth noting that negotiators assess their own and their counterpart's goals independently. In other words, the self-interest perception does not influence the perception of concern for others (Thomas and Schmidt, 1976). Precisely high self-interest perception might be joined with either high or low concern for others and vice versa.

The extent of concern for self-interest and the extent of concern for others, identify the strategic approaches of a particular negotiation. Specifically, high concern for self-interest and low concern for others result in contending strategies. Inversely, low concern for self-interest and high concern for others result in conceding strategies. These two strategies are part of distributive strategies (Pruitt and Carnevale,

1993; Thomas and Schmidt, 1976), which consist of distribution of values where one party or neither party wins.

On the other hand, when high concern for self-interest is combined with high concern for others, the negotiators will pursue integrative strategies (Pruitt and Carnevale, 1993; Thomas and Schmidt, 1976), these strategies result in the creation of values and result in win-win outcome.

Finally, compromise strategy involves medium concern for self-interest as well as medium concern for others. The aforementioned typology of negotiation strategies is named "dual concern" (Thomas and Schmidt, 1976; Pruitt and Carnevale, 1993).

Different tactics enables negotiators to pursue a particular strategy. For instance, actors can threaten the other party and use all the available pressure to achieve the best outcome possible under the contending strategy. They can instead choose to adapt their position according to their counterpart's preferences when they concede to their clients. On the other hand, negotiators can reciprocate concessions or move to an in between solution when they use a compromise strategy. Finally, when actors use integrative strategies they can use tactics that enables them to trade different issues, give promises for future negotiation, and use compensations and rewards.

It is worth noting that distributive and integrative strategies operate in a continuous dimension, Putnam (1990:5) suggests that: "integrative and distributive processes are intertwined in a symbiotic bonding that pervades negotiations". Therefore, conciliatory and contentious behaviour are both required for reaching agreement and for achieving personal advantage. In order to achieve the best-preferred outcome, negotiators need to compromise between the concern for self-interest and the concern for others and not only to focus on their own self-interest.

Figure 3 below illustrates how the combination of direct self-interest and concern for client's interests lead to different negotiation strategy.

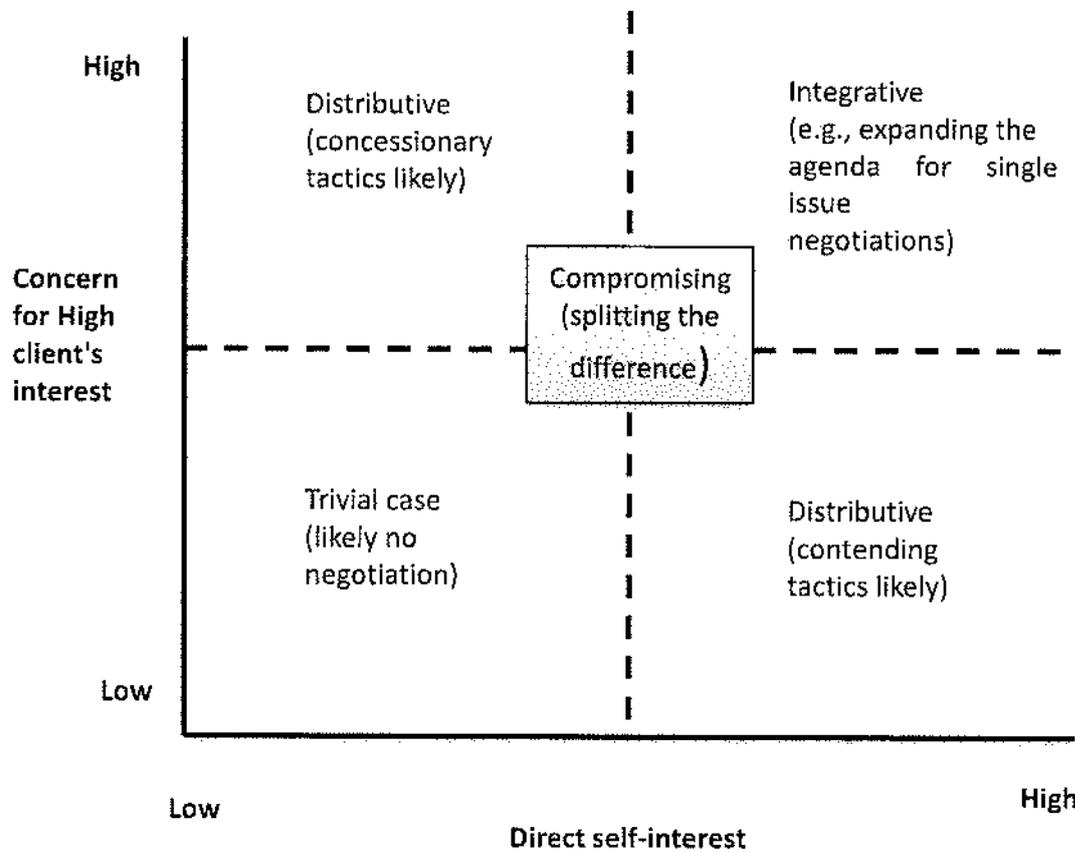


Figure 3: Auditor motivation in situation affecting negotiation strategy selection
 Source: Salterio (2012:245) "Fifteen years in the trenches: Auditor-client negotiations exposed and explored" Accounting and Finance (2012 Supplement)

2.6 The auditor's negotiation strategy

According to prior auditor-client negotiation research (Goodwin, 2002), auditors use similar strategies to generic negotiation strategies (Blake and Mouton, 1964; Thomas and Kilmann, 1975; Rahim, 1983). Further Gibbins et al. (2010) suggest that the strategies used by auditors are very similar to generic negotiation strategies but adapted to an auditing context. In the following discussion, we will rely on conventional negotiation typology to discuss research on auditor-client negotiation strategies.

2.6.1 Distributive strategies

Negotiation strategies are divided into two main groups: distributive strategies and integrative strategies. In generic negotiation, distributive negotiation strategies are widely used by negotiators. Similarly in the auditing context, almost half of the participants of Gibbins et al. (2001) study believe that there is a range of alternatives somewhere between the initial position of the auditor and that of the client, which indicates distributive negotiation strategies. Further, the chief financial officers in Gibbins et al. (2007) study consider that negotiation outcome would be distributive. Distributive strategies consist of “a procedure for dividing a fixed pie of resources” (Bazerman, 1986:123). Therefore, the resulting outcome of such strategies is distributive where one negotiator wins over his counterparts or both parties lose. The three main distributive strategies: Conceding, contending and compromising are presented in the following sections.

2.6.1.1 Contending

Pruitt and Carnevale (1993:30) suggest that the objective of contending strategy is “to make the other party make concessions or to resist similar contending efforts by others”. Negotiators adopting this style are more interested in serving their self-interest than that of their counterparts. From the client’s perspective, distributive strategies involve essentially imposing one’s position by using tactics such as threats of non-renewal of the contracts and harassment. From the auditor’s perspective, these strategies involve threatening to qualify the audit report if the required audit adjustment is not made.

2.6.1.2 Conceding

This strategy is characterized by a low concern for self and high concern for others, and results in a lose-win outcome. Negotiators in this situation may neglect their interests in

order to allow the other party to win (Pruitt and Carnevale, 1993). Conceding, thus “involves changing one’s position to provide less benefit to oneself and therefore more benefit to the other party” Pruitt and Carnevale, 1993:28). For instance, auditors have an interest to waive immaterial audit adjustment and therefore make concessions on these inconsequential items so that the client concedes on material adjustments (Sanchez et al., 2007).

2.6.1.3 Compromising

This strategy is characterized by concern for self as well as concern for others. It leads to a no-win, no-lose outcome and can be regarded as a mid-point between the contending and conceding strategies because both negotiators shift from their best alternative towards an “in between” solution. Pruitt (1991) suggests that this strategy can be regarded as integrative given that it involves, to some extent, elements of both assertiveness and cooperativeness.

An example of this could be an auditor faced with high engagement risk and therefore must be concerned about their reputation, but at the same time, they cannot ignore the client’s interests given the size and importance of the client’s account. On the other hand, the client would have an interest to cooperate with the auditor to avoid a modified audit report. In this case, the two parties will build a mutual commitment to consider each other’s interests, which is the essence of compromising strategies.

2.6.2 Integrative negotiation strategies

These strategies involve high concern for both self and others and call for participants to work jointly to create win-win solutions. They involve understanding each other’s interests and searching for alternatives that are acceptable to both parties. Negotiators are encouraged to look for different ways to create value and develop shared principles

as a basis for decision making about how outputs should be claimed. These strategies view conflict resolution as possible by exploring differences and looking for alternative solutions to those initially considered (Rahim, 1983). It is worth noting that integrative strategies are more difficult to implement compared to distributive strategies (Pruitt and Carnevale, 1993).

In fact, only 13% of audit partners in Gibbins et al. (2001) study reported they planned finding a new solution to resolve negotiation issues, which indicates the use of integrative strategies. Problem solving and expanding the agenda of issues represent the strategies that negotiators employ when they want to realize integrative outcomes.

2.6.2.1 Problem solving

Users of this strategy should consider the mutual interests of both parties and look for an original solution that was not among the range of alternatives considered initially. From the auditor's side, this strategy consists of searching for a solution that allows her/him to reach her/his objective and preserve client's interests at the same time. This is possible when the auditor suggests a solution for the issue under negotiation that enables the client to reach her/his objectives in terms of thresholds of earnings or analysts' forecasts etc. and that guarantee the conservatism of auditors especially when the client is not committed to a particular accounting treatment. The role of the auditor is then to look for an accounting treatment that complies with GAAP and allows the client to reach their thresholds.

2.6.2.2 Expanding the agenda of issues

As indicated by its name, this strategy implies proposing additional issues to the negotiation table in a way that resolving the set of issues provides benefits for all the parties. This will enable parties to concede on some issues so that they achieve their

most preferred position on essential issues (Lax and Sebenius, 1986; Neale and Bazerman, 1991). For instance, Hatfield et al. (2008) and Sanchez et al. (2007) found that warning the clients about immaterial misstatements that the auditor waived results in more cooperation from the client who is more willing to concede on material adjustments.

2.6.3 Prior negotiation strategies research

Prior research has studied the negotiation strategies that auditors may pursue when they resolve contentious accounting issues. Fundamentally, the objectives of these studies was to study under what condition they follow a specific negotiation approach; this includes individuals' characteristics and contextual features of the auditing environment. This research has shown that when auditors concede on immaterial and inconsequential issues, the client reciprocates this concession and makes the material adjustments required by the auditor (Sanchez et al., 2007). Furthermore, Trotman et al. (2005) provided evidence that role-playing results in a better negotiation outcome as compared to the outcome realized when auditors have more experience and when they use passive methods. When auditors concede gradually or use end concessions, clients' management cooperate more on income decreasing adjustments as compared to when they do not concede (Tan and Trotman, 2010).

Further, Cheng et al. (2016) replicated this study to multiple period negotiation, however, they found that client management respond better to no concession strategy in the preceding period as compared to gradual or end concessions.

Goodwin (2002) has studied the approaches auditors pursue when they resolve contentious accounting issues, and found that they tend to use more integrative

strategies as compared to compromising and dominating strategies. Auditors in their study almost never employ the obliging and avoiding styles.

Furthermore, there is a difference between partners and managers negotiation approach. More precisely, audit partners use more assertive approaches as compared to managers. Trotman et al. (2009) found that auditors pursue distributive strategies more than integrative ones. However, audit partners in Gibbins et al. (2010) report that they are more willing to use integrative strategies as compared to distributive strategies, but audit partners tend to adjust their strategies to more contending strategies when they are faced to an inflexible client.

2.7 Summary

This chapter has presented three different research streams essential to understanding the background of auditor- client negotiation: (1) Generic negotiation research, (2) Auditor-client negotiation studies and (3) auditor- client negotiation strategies.

The diversity of generic negotiation approach is due to the diversity of the disciplines they are driven from and to an advanced knowledge of the negotiation process. In this chapter we presented an overview of the more advanced classifications, i.e. Raiffa et al. (2002) and Zartman (1988) typologies.

Auditor-client negotiation research identifies contextual features that have an impact in auditor-client negotiation and the review of prior research provides a solid ground when developing hypotheses. This synthesis builds on the Gibbins et al. (2001) model where antecedents are grouped into three subcategories: external conditions and constraints, parties' capabilities and interpersonal context.

Several insights could be drawn from this literature review. First, the contextual variables did not receive the same attention, i.e. some have been empirically validated several times while others have not been tested at all. Second, these studies show that findings related to the effect of some contextual features are mixed, i.e. effect of the engagement risk and auditor experience. Furthermore, despite the significant number of research investigating the auditor-client negotiation, none of the studies investigated the negotiation through a decision- making process lens

Finally, this chapter relied on conventional negotiation typology to discuss research on auditor-client negotiation strategies as auditors use similar strategies to generic negotiation strategies (Blake and Mouton, 1964; Thomas and Kilmann, 1975; Rahim, 1983), i.e. distributive strategies and integrative strategies.

Chapter 3: Conflict of interests and bargaining power

3.1 Introduction

The purpose of this chapter is to explain how conflict of interests and bargaining power influence auditor-client negotiation. I first start with the conflict of interests which is an important feature of the audit environment and discuss how negotiation could be a tool to resolve this conflict. The second section of this chapter discusses bargaining power with its main conceptions, i.e. potential power, perceived power, power change tactics and realized power.

This chapter emphasizes the idea that auditors are always faced with conflict of interests. In light of this a successful auditor is the auditor who succeeds to navigate these conflict of interests. The discussion on bargaining power reveals that auditors may not use all their potential power in the course of negotiation when they want to keep good relationship with their client.

3.2 Motivational factors and conflict of interests

Auditors are often faced with conflicts of interest involving their desire to keep good relationships with their client and their professional duty of providing an opinion about the economic situation of the firm they are auditing. This conflict of interest resulted in a series of corporate scandals in 2003 and auditors have been accused of being accomplices with client management in biasing financial reports (Levitt and Dwyer, 2002). It is logical to believe that auditors who are often hired and paid by managers have an interest to find means to persuade managers to record appropriate audit adjustments when it is needed and hence avoid providing negative audit opinions in an attempt to keep good relationship with managers.

3.2.1 Resolving conflict of interests by negotiation

Auditors often deny that they negotiate with their clients and claim that their judgement is unaffected by such conflicts of interest. Furthermore, many believe that these criticisms are mainly from unfair academicians (Moore et al., 2006). However, both recent events and recent research confirm the impact of conflict of interest on auditor's decisions. Moore et al. (2006) advanced that auditors' opinion is influenced by these conflicts of interests and that auditors are not always conscious of this bias.

Because conflicts of interest are unavoidable and cannot be reduced to zero (Moore et al., 2006), a successful auditor is the auditor who succeeds to find means to navigate these conflict of interest. Negotiation is considered as a tool, which enables auditors to successfully navigate these conflicts of interest in a legitimate way.

Furthermore, the audit profession is regulated by a set of rules, which make auditor negotiation an essential part of the auditing process; in practice auditors are hired and fired by client management, auditors who take positions with the clients and the non-audit services that auditors offer to their clients.

First of all, clients prefer auditing firms who are likely to issue clean audit opinion. Thus, the likelihood that clients will fire the auditor after issuing an unfavourable audit report is important. Therefore, auditors have interest to issue audit reports in line with client's desires (Levinthal and Fichman, 1988; Seabright et al., 1992). In light of this, negotiation presents a way to convince client management of the adjustment's records and to avoid the qualification of audit reports.

Second, auditors' resistance to their clients' preferences is exacerbated by the relationship that might develop with the client management. Thompson (1995) suggests that even basic affiliation with partisan interests results in the interpretation of

information in a way that pleases the partisan. Indeed, several studies have found that auditor acquiesces to their clients increase over time and as the auditor-client relationship lengthens (Mautz and Sharaf, 1961; Beck et al., 1988).

Finally, this auditor-client relationship is accentuated by the presence of non-audit fees. Prior research has shown that important consulting fees resulted in auditors' estimation bias (Frankel et al., 2002; Ruddock et al., 2004). This shows that auditors are structurally highly independent to their clients, and that negotiation can be a helpful tool helping them keeping their job without neglecting their professional obligations.

3.2.2 How Conflict of Interests Affect Judgment

Some evidence has suggested that auditor's judgement is influenced unconsciously by conflict of interest. This fact can also help explain why auditors use concessionary negotiation strategies in certain circumstances.

Generally, researchers tackled the auditor independence problem under the economic approach which assumes that auditor choose to exercise the auditing task in a honest way and provide unbiased reports to investors or to be accomplice with client management in misleading investors (De Angelo, 1981; Antle, 1984; Simunic, 1984). However, the research line of motivated reasoning and self-serving biases challenged this assumption, and advanced that the impact of conflict of interest should be explained by the unconscious bias rather than intentional corruption.

Selective perception. Research on unconscious bias suggests that individuals fail to evaluate the information objectively and tend to consider their self-interest first. In fact, individuals think always that they deserve more when they allocate resources (Messick and Sentis, 1979). Arguments that are in line with the individual's preferences are often easy to find and people emphasis these arguments when they make decisions (Messick

and Sentis, 1979; Diekmann, 1997; Diekmann et al., 1997). For this reason auditors should be aware of the impact of this selective perception bias (Thompson and Loewenstein, 1992; Babcock and Loewenstein, 1997).

Individuals seem to emphasize evidence that enables them to reach the conclusion they want to achieve. Hence the degree of self-interest prevalent influences auditors' focus on that particular evidence (Holyoak and Simon, 1999). This explains why given the same audit issue auditors use different negotiation strategies while faced with different contexts.

When they cannot ignore conflicting evidence and the accounting issue at hand is complex, auditors often engage in distribution strategies (conceding or contending) and less in integrative strategies. This depends on the degree of self-interest, that is if their self-interest is threatened such as in the case of a great litigation exposure they will use contending strategies and they will threaten to qualify audit reports if the clients do not record necessary audit adjustments. On the other hand, auditors chose to concede to their client's preferences if they are threatened with losing their clients.

Plausible deniability. Making biased judgement is more likely when people just confirm evaluations made by others than when they give estimation from scratch, this evidence is confirmed by Diekmann et al. (1997). Furthermore, the duty of auditors is to approve the compliance of client's reports to the GAAP. This makes auditors more inclined to accept the client's reports.

Escalation of commitment. Many have argued that audit firms are faced to the choice between a certain loss of the client on one hand and the uncertain risk of a harsh litigation penalty on the other. Researchers argue that the choice is in favour of the risky option (Kahneman and Tversky, 1979). In this context, accounting firms seek to

develop a relationship with client and to develop a business, this is possible by reconciling the immediate, certain effect of losing the clients and the uncertain future legal costs.

When financial incentives contradict professional obligations, auditors may be induced to give in to their client's wishes. Conflicts of interest are definitely considered as an obstacle for auditors to make objective estimations, although professionals rarely admit that their judgement is influenced by conflicts of interest.

In his testimony before the SEC, Gary Shamis, the chairman of the Management of an Accounting Practice Committee of the AICPA, stated, "We take the existing independence rules quite seriously, and consequently abide by all the existing rules. We are professionals that follow our code of ethics and practice by the highest moral standards. We would never be influenced by our own personal financial well-being" (Shamis, 2000). Moore et al. (2006) consider that these noble sentiments do not guarantee objective judgement.

3.3 Bargaining Power

One factor that is widely suggested to affect auditors' performance in negotiation is power (Beattie et al., 2004; Brown and Wright, 2008). Auditor negotiation power is fundamental for their success, because it can determine whether the negotiation outcomes will be in their favour. The greater the auditor's power relative to the clients, the more adjustments they should be able to claim and the better the financial statements' quality should be. This is why accounting regulatory reforms are replete with recommendations to improve auditor's power position (e.g., SOX, 2002).

Yet Auditors who wish to improve their power should realize that power might be influenced by a wide range of factors, related to the environment where they operate, their abilities and those of their counterparts.

Power can be decoupled into four distinct components: (1) potential power, the underlying capacity of negotiators to obtain benefits from their agreement, (2) perceived power, negotiators' assessments of each party's potential power, (3) power tactics, behaviours designed to "use" or "change" the power relationship, and (4) realized power, the extent to which negotiators have claimed benefits from the interaction.

3.3.1 Main conceptions of power

Power is considered as the likelihood that individuals achieve their will even when there is resistance (Weber et al., 1947). However, despite the consensus among scholars on this definition (Bacharach and Lawler, 1981), theorists have approached power from different foci, mainly. (1) bases of power as suggested by French et al. (1959); (2) the influence of tactics by Kipnis et al. (1980); and (3) power dependence theory by Emerson (1962). In what follows, we will provide an overview of these typologies and apply them to the auditor's power.

3.3.1.1 Auditor's Power Bases under French and Raven's (1959) Typology

According to French and Raven (1959), power is determined by the characteristics of the relationship between both parties. They particularly suggest that the relative power of X over Z is function of five factors. First, the capacity of X to offer advantages to Z (reward power). Second, her/ his ability to sanction X if the latter does not acquiesce with his desires (coercive power). Third, X's having essential skills (expert power). Fourth, her/his legal authority to impose actions on Z (legitimate power). Finally, the degree to which Z refers to her/him (referent power).

Reward power: Auditor's power over his client is determined by the extent of her/his ability to reward the latter. In this light, the more the auditor can offer advantages to the client the more (s)he has power over him. For instance, waiving particular adjustments so (s)he reaches her/his bonus target, and the extent to which the client believes that the auditor controls these rewards.

Coercive power: Auditors' (Client's) power over the client (the auditor) is determined by the extent the client (the auditor) can be sanctioned by the auditor (the client) by qualifying the audit report (by firing the auditor). Also the extent to which the client (the auditor) assumes this sanction is avoidable if s/he acts in accordance with the auditor's (the client's) wishes by recording the appropriate audit adjustments (by waiving audit adjustments).

Expert power: Auditor's (client's) power over the client (the auditor) is a function of the client's (the auditor) perception that the auditor (the client) has the needed knowledge or expertise, I argue that auditors have advantages over this power as his accountancy expertise is often considered as higher than the client's expertise. However, this power is relative given that it could be influenced by experience and industry specialization, and clients may have more power over auditors if the latter is newly hired and s/he does not know the industry/ company very well.

Legitimate power: the auditor's (the client's) power over the client (the auditor) is identified by the extent of the client (the auditor) perception that the auditor (the client) has the legitimate power to influence the client (the auditor). The auditor has also advantages over this power since he has the power to qualify the audit report and without his opinion the client will not be able to release their financial statements.

Referent power: The auditor's (the clients') power over the client (the auditor) is determined by the relationship between the auditor and the client and thus, how much the auditor can use this relationship to influence the client's approval. This power is influenced by the extent to which they are keen to maintain a good relationship and to maintain a good working environment.

3.3.1.2 Typology of Influence Tactics (Yukl and Tracey's (1992))

Kipnis et al. (1980), with subsequent extensions by Kipnis and Schmidt (1983) and Yukl and Tracey (1992), focus on identifying and categorizing the tactics commonly used by managers when attempting to get others to comply with a request. Taken together, these programs of research identify nine dimensions of this typology that can be used by negotiators, these are: influence, pressure, legitimation, exchange, coalition, ingratiation, rational persuasion, inspirational appeal, consultation, and personal appeal. This framework considers how one's power relationship with others can influence the likelihood that these different influence tactics will be used (Yukl and Tracey, 1992). The main idea with this typology is that the use of a particular tactic depends on the initiator power over his counterpart.

Pressure: The auditor uses demands, threats, or intimidation to increase the client's compliance by threatening to qualify the audit report.

Legitimation: The auditor attempts to legitimize a request for compliance or claim the right to request it by referencing GAAP.

Exchange: The auditor uses implicit or explicit promises to reciprocate and concede on other accounting issues if the client complies.

Coalition: The auditor may seek the help of others such as the audit committee to help him persuade or pressure the target to comply, however the success of this tactic depends on the strength as well as the willingness of the third parties to help.

Ingratiation: when the auditor client relationship is positive, the auditor might attempt to use the favourable impression that the client has of her/him in order to improve the client's mood before requesting compliance and accept the audit adjustments.

Rational persuasion: The auditor uses logical arguments and information to support the viability of complying with the request and convince the client that his alternative is the best, this tactic is found to be especially useful in the context of judgemental accounting issues.

Inspirational appeal: The actor makes an emotional appeal for compliance by appealing to the target's values and ideals; Although this tactic may apply to charities and some ethical companies, it is hardly to be applied in the context of audit of companies.¹

Consultation: The auditor and the client work jointly in order to find a mutual agreement on the issue under negotiation, hence the auditor seeks the target's participation in the decision making process and the implementation of the request.

Personal appeal: The auditor appeals to the client's sense of loyalty or friendship when they have cordial and positive relationship before requesting his compliance.

For example, Yukl and Tracey (1992) found that inspirational appeal, ingratiation and pressure, were used most in a down ward direction, in other words when the power is in favour of the imitator's related to their counterparts. Personal appeal, exchange and legitimation were used when both initiators have equal power; they found also that

¹ We exposed this tactic to be loyal to Yukl and Tracey's (1992) framework

negotiators used coalition when both parties have equal power or when the target has more power relative to the initiator; and that rational persuasion was used most in an upward direction i.e. when the initiator has less power than the target.

Furthermore, according to this framework rational appeal, persuasion and consultation allows for better negotiation outcome as compared to others tactics.

3.3.1.3 Power-dependence theory

Emerson (1962) conceptualises power in term of relative and total power. Emerson suggests that, "The power of A over B is equal to and based upon the dependence of B upon A" Emerson (1962:32-33). The author states that dependence depends on the importance of the value of the negotiation outcome and the possibility of achieving the outcome using other options. Therefore, auditor's power related to his client depends on the extent to which the client relies on him. That is the degree to which the client achieves advantages and avoids harm when he retains the auditor compared to the advantages he receives when he recruits a new auditor. This can result in serious consequences for the company. Similarly, the client's power over the auditor depends on the advantages that the auditor receives when s/he remains with the client as compared to the advantages s/he realises when s/he quits the client. Given that this framework does not assume total power (i.e. the sum of audit and client power equal zero), an improvement in one's power does not harm the other's power).

Consequently, the aforementioned power frameworks provided essential concepts related to power. In what follows we will try to fully explicate what power is: Where power comes from? How power is perceived? And the ways in which power can be used or changed.

3.3.2 Auditor's potential power

The conceptualization of auditor's potential power is allowed by following generic negotiation research, which relies on power dependence theory to define the potential power. In this context, the auditor's potential power consists of the ability of negotiators to acquire advantages in negotiation. Thus, auditors' potential power is defined as their ability of recording the desired audit adjustments.

Consistent with power dependence theory, auditor's potential power is identified by his client's dependence on him. Further, two dimensions identifies this dependence: firstly the opposite member's assessment of the negotiation (Mannix, 1993; Kim, 1997), that is the extent to which the client needs the approval of the auditor. Secondly the importance of the opposite member's best alternative (BATNA) when there is no agreement (Pinkley and Northcraft, 1994), which is related to the extent that the client has other means to reach his target.

Similarly, the importance of negotiation to auditors' is function of their evaluations of its consequences e.g. reputation, revenues etc. Similarly, auditors' estimation of their options depends on the possibility of obtaining these advantages by different means.

3.3.3 Auditor's perceived Power

The perceived power is the negotiator's estimation of his potential power over his/her opposite party. Therefore, both the client and the auditor are assumed to develop perceptions about their respective potential power and about that of the opposite party. However, considering that auditors operate in a specific auditing context, their perceptions of each party's negotiation power, depends on the situation and the way it is interpreted.

Specifically, I argue that information related to the values of the resources that the negotiation would provide, the likelihood of obtaining those resources, and their importance influence the relationship between potential and perceived power, as it is explained below.

Generally speaking, auditors have complete information about their client's BATNA (best alternative to the negotiated agreement) given that the later has an interest to disclose their preferences and that unaudited balances represent these preferences anyway. Moreover, auditors generally assess their BATNA accurately and hence, have an exact evaluation of the outcome each option would provide to them (i.e. an auditor knows exactly the outcome that could be obtained from all the possible alternatives). However, clients may miss the auditor's preferences; consequently, they do not have an accurate assessment of what the other party contributes to negotiation. This lack of familiarity means that the auditor possesses advantages over potential power due to his accurate perception of the values and the probability of their BATNA and those of their client.

In conclusion, BATNAs estimation influences positively the association between potential and perceived power. Lack of information about these values and their probabilities, in contrast, may lead to a divergence between these two values.

Auditors should evaluate their BATNA both in terms of quantity and in terms of their likelihood of realisation. In addition, they should consider the importance of those outcomes both for them and for their clients. The negotiation literature distinguishes between the interests and priorities (Lax and Sebenius, 1986). In this context, the interests involve all the resources that provide advantages to the negotiation (e.g. all the acceptable alternatives that add value to the negotiator's total outcome in the audit

context). This could be related to any alternative that is compliant with the GAAP and does not harm his reputation. On the other hand, priorities involve the resources that offer the greatest advantages compared to others (e.g. the auditor would prefer the most conservative alternative). This explains why auditors fail to bring significant value to the negotiation even if they make concessions when this concession involves immaterial and inconsequential items to the financial statements.

To avoid false assumptions, auditors should identify the importance of the discussed issues to their clients since the identification of these values improves the links between the potential and perceived power.

3.3.4 Power Tactics

Power tactics seek to implement and modify structural power relationships between negotiators. Specifically, negotiators try to control the power by power use tactics, while trying to alter the power relationship. Typically, to improve their own power relative to that of the other party they redesign power by change tactics (Lawler, 1992). These two components will be discussed below.

3.3.4.1 Power-change tactics

When auditors perceive that their potential power is less than that of their clients, they will implement efforts so they can bring power into their favour. In this light, the perceptions of auditor of their potential power will identify tactics to be employed to change the power based on the dependence theory discussed earlier. In addition, it can be inferred that power change tactics seek to alter the power relationship. In fact, negotiators may (1) improve the quality of their BATNA, (2) decrease the quality of the counterpart's BATNA, (3) decrease their valuation of the counterpart's contribution, or

(4) increase the counterpart's valuation of their own contribution (Bacharach and Lawler, 1981).

These tactics involve essentially dependence changes, thus it seeks to reduce auditor's dependence on his client by minimising the client's power (Tactic 1 and Tactic 3) or to increase the client's dependence on him (Tactic 2 and Tactic 4).

It is worth noting that characteristics of the negotiation context influence the use of power-change (Jacobsen and Cohen, 1986). Similarly, auditors' potential to enhance their negotiation position may be limited by certain factors such as accounting and negotiation experience, accounting environment characteristics which includes nature of GAAP in use, or deadline pressure etc.

We should also note that, despite the fact that change tactics involves modifying "potential power", which has consequences for perceived power; it is possible that these change tactics influence directly the perceived power. In this context, individuals may attempt to enhance their own BATNA or simply mislead the counterpart into believing that his or hers or to make their counterparts perceive their own BATNA is more important than what it actually is. Individuals may also work on improving the accuracy of their counterparts' perception of their own contribution when they believe this perception is less than it actually is. Negotiators initially assess the power they possess and try to adjust it using change tactics in order to affect their perceived power and obtain the desired outcomes. When the desired perceived power has not been obtained, negotiators initiate additional power change tactics because it is possible that all individuals try to bring power in their favour, thereby cancelling out some of the change effects, which will cancel initial power change effects (Diamantopoulos, 1987).

3.3.4.2 Power-use tactics

Auditors usually select power use tactics according to the perception of the power they possess over that of their client. As discussed earlier, generic negotiation research has identified nine power use tactics, namely influence, pressure, legitimation, exchange, coalition, ingratiation, rational persuasion, inspirational appeal, consultation, and personal appeal (Kipnis et al., 1980; Kipnis and Schmidt, 1983; Yukl and Tracey, 1992). In the same vein, Lawler (1992) has suggested a more general framework between power use tactics and distinguished between conciliatory and hostile power-use tactics. Whereas conciliatory tactics involves employing positive acts, like showing an intention of cooperation, hostile tactics involves using negative acts, such as revealing the consideration of self-interest only.

The likelihood of using more hostile tactics is greater compared to conciliatory tactics when there is a difference in power between negotiators and when parties perceives differently the legitimacy of this difference. Thus, auditors will be more inclined to employ hostile strategies when they perceive they have more power than their clients but also when they have less power (e.g. they will threaten the clients with qualifying the audit report in both extreme power level. Second, when negotiators have both equal power (especially when it is high), the possibility of achieving an acceptable outcome is greater, and therefore, they will use more conciliatory tactics as compared to hostile one. According to Lawler (1992) the costs to the counterparts can be mitigated by employing conciliatory tactics which involves more cooperation from the initiator, whereas hostile tactics exacerbate the costs incurred to the counterparts. These tactics involve intimidating and threatening the opposite party.

The cost of using a particular tactic varies with different considerations, this can be explained drawing on Kipnis et al. (1980) work. According to Kippins and his

colleagues, a negotiator may attenuate the costs by looking with the counterpart for solutions that are acceptable for both of them (e.g. looking for an acceptable accounting alternative for both the auditor and the client). For instance, the client may be interested in accounting figures that allow him to reach certain thresholds such as sales or analyst target without being stuck to a particular account balance. It is the auditor's job then to find a way that helps him to do so, while remaining in the GAAP boundaries. The above-mentioned costs could be also attenuated by using inspirational appeals in order to influence the counterpart's priorities and make her/him accept the concessions. It is sometimes useful for auditors to play with their inspirational appeals and make their clients accept their position or (3) by persuading the counterpart of the rationality of their proposition, indeed when the issue at hand is subjective and judgemental by nature, auditors must use strong arguments that support their alternative.

On the other hand, these costs can be exacerbated when the negotiator put pressure on the target by intimidating and threatening them. For instance, the client management is obliged to record all the adjustments required by the auditors when they are threatened with getting a modified audit report. In such situations, they do not only miss their thresholds but they will also lose their self-esteem and confidence in auditors. Furthermore these costs can be exacerbated by seeking the help of others to increase this pressure, this will magnify psychological costs to the target, auditors can rely on third parties such as audit committee especially after the reinforcement of their roles in the audit process (SOX, 2002); Finally, these costs are exacerbated by relying on regulations. However, the implementation of this tactic is limited to the availability of the accounting standards (Ng and Tan, 2003). Lastly, exchange, ingratiation, and personal appeal do not have an impact on the costs to the target.

The implementation of hostile tactics does not require considering counterparts' interests whereas conciliatory tactics require considering these interests. This means that generally conciliatory power-use tactics will be more difficult to apply than the hostile ones. Similarly, the counterparts make more effort to resist hostile tactics, which make these tactics less successful than conciliatory tactics.

3.3.5 Realized Power

Realized power represents the advantages that negotiators demand from the negotiation. How much negotiators realize power depends on the efforts used to change power dynamics. Furthermore, the realised power affects power relationship and thereby the future potential power. According to Lawler (1992), taking more advantages in current negotiation can result in harming the relationship between both parties which will result in a reduction of the independence of the counterpart's thereby the reduction of future potential power (Emerson, 1962; Lawler, 1992).

However, the extent to which the future potential power depends on the power change tactics used. Precisely, users of conciliatory power tactics (i.e. tactics that enables one to take advantages while preserving the interests of the counterpart) can maintain positive relationship with the counterparts and therefore protect future potential power.

On the other hand, hostile power-use tactics prevent their users to take advantages while minimising the costs for their counterparts. This will harm the relationship between both parties and hence affect future potential power. These conclusions highlight important points about the power dynamics. Most importantly, auditors may choose not to use all the possible power in order to maintain future potential power; this is especially prevalent when the negotiation entails more than one period. Thus, auditors do not think of the consequences to the current period of negotiation but also think of the

consequences for relationships with the client, especially that the audit process is generally a multi period exercise.

In single-period negotiation, auditors are likely to be interested in realizing all the possible power. This situation may happen when auditors are in their final period and they are not expecting a renewal. Whereas in continuing relationships, auditors will take into consideration the implications that the realized power will have on future negotiations, e.g. auditors will consider the implications for their relationship with their clients when they negotiate if they are seeking a renewal for the audit mandate. Overall, realized power depends on the auditor's perception of future negotiation.

While audit firms are "(re) appointed each year, it is often expected that their tenure will be multiperiod. Therefore, it is expected that this would have consequences on auditor-client negotiations.

3.4 Summary

My purpose in this chapter has been to develop a comprehensive framework of how conflict of interest and bargaining power can affect negotiation judgements and to present power conceptions in the context of negotiation. My discussion of conflict of interests reveals that these conflicts are unavoidable and cannot be reduced to zero (Moore et al., 2006), and a successful auditor is the auditor who succeeds to find means to navigate these conflict of interest. Therefore, negotiation is considered as a tool, which enables auditors to successfully navigate these conflicts of interest in a legitimate way.

One factor that is widely suggested to affect auditors' performance in negotiation is power. In fact, auditor negotiation power is fundamental for their success, because it can determine whether the negotiation outcomes will be in their favour. The greater the

auditor's power relative to the clients, the more adjustments they should be able to claim and the better the financial statements' quality should be. This is why accounting regulatory reforms are replete with recommendations to improve auditor's power position (e.g., SOX, 2002).

Power can be decoupled into four distinct components: (1) potential power, the underlying capacity of negotiators to obtain benefits from their agreement, (2) perceived power, negotiators' assessments of each party's potential power, (3) power tactics, behaviours designed to "use" or "change" the power relationship, and (4) realized power, the extent to which negotiators have claimed benefits from the interaction. The discussion in this chapter revealed that potential power can be different from realized power when the auditor wants to keep positive relationship with the client for the future.

Chapter 4: The decision-making making process in an auditor- client negotiation context

4.1 Introduction

This chapter will discuss Judgment and decision-making (JDM) research in auditing. Especially s to learn about how individuals make judgement and how these can be ameliorated (Trotman, 1998; Hogan and Jeter, 1999). The second main objective of this chapter is to discuss auditor-client negotiation through the lens of the Throughput model theory.

Rodgers (1997) model emphasise the importance of developing accurate descriptions of the pathways used by decision makers. It acknowledges that decision makers do not intuitively act rationally, and identifies the systematic pathways in which decision makers depart from rationality as well as what could be expected from following a particular pathway (Foss and Rodgers, 2011).

The following sections are structured as follows: Section 4.2 provides an introductory general review of research in the field of audit judgment and decision-making (JDM). It sets the scene and gives a brief overview of the development and purposes of audit JDM research. Section 4.3 introduces the Throughput model and presents it in the auditor-client negotiation context.

4.2 Audit judgment and decision-making (JDM) research

Judgment and decision-making (JDM) research in auditing has been widely influenced by psychology, more precisely by behavioral decision theory. The objective of audit

judgement research is to learn about how individuals make judgement and how these can be ameliorated (Trotman, 1998; Hogan and Jeter, 1999).

According to Trotman (1998), Judgement decision making research is concerned with four main objectives. Firstly the evaluation of judgement's quality which concerns mainly the extent of agreement between auditors (Trotman and Yetton, 1985); the preciseness and homogeneity of audit judgments (Trotman, 1998); the degree of audit judgment bias caused by the effect of heuristics (Kennedy, 1993; Anderson and Maletta, 1999) and anchoring (Joyce and Biddle, 1981; Kinney Jr and Uecker, 1982).

Secondly, another line of research in audit judgement research was concerned with the description of the process of audit judgement and decision making along with the investigation of potential factors that determine these processes. The resulting theories are information choice and information processing which seek to understand how the information is used when auditors make judgement. A third objective for audit judgement researchers was to investigate the impact of knowledge and memory in audit judgement process. Interestingly, Ramsay (1994) provided evidence that seniors – reviewers at lower level, perform better in mechanical errors detection whereas managers – reviewers at higher level, perform better in conceptual errors detection. These findings suggest that audit firms should assign different people according to the skills required for a particular audit task. Fourth, audit judgement investigated the way audit judgement quality can be improved, for instance the impact of the feedback of the review (Miller et al., 2006) and the form of the review e.g. online or face-to face interview (Agoglia et al., 2009; Payne et al., 2010).

Research on audit judgement decision-making that is directly related to the present study is the effect of heuristics and biases in audit judgment, which represents an

important line of research in audit judgement decision-making studies. Furthermore, the present study is situated in multi-person judgment and decision-making research, which is concerned with the interactions between individuals: e.g. auditors and their clients in auditor-client negotiation and auditor with financial staff in the financial reporting process (Nelson and Tan, 2005).

4.3 The Throughput Model Theory (TP)

The TP model offers insights from social psychology into a descriptive model of how negotiators make decisions. This model has been validated empirically in different contexts. The first application of this model was when studying the effect of information and cognitive processes on decision making (Rodgers and Housel, 1987). Furthermore this model has been applied successfully in auditing, especially to understand how biases influence auditing opinions (Guiral et al., 2015), how auditors make decisions using information related to environmental risk (Rodgers and Housel, 2004) and to study the effect of knowledge transfer on professional skepticism in audit engagement planning (Rodgers et al., 2017). Moreover this model has been used to study how investors value corporate social activities (Rodgers et al., 2013).

The TP model helps identify and explain the effect of perceptions that auditors have of the negotiation situation such as environmental contextual features and client characteristics on the negotiation process.

Rodgers (1997) developed a decision making model that describes how decision makers actually behave rather than how they should behave. The model portrays the importance of developing accurate descriptions of the pathways used by decision makers. It acknowledges that decision makers do not intuitively act rationally, and identifies the

systematic pathways in which decision makers depart from rationality as well as what could be expected from following a particular pathway (Foss and Rodgers, 2011).

4.3.1 The components of the Throughput Model

The model as shown in Figure 4 has four components: perception (P), information (I), judgment (J) and decision (D). As claimed by this model, perception and information leads to judgment in a first phase then perception and judgment leads to a decision in a second phase. The perception concept indicates that decision makers frame situations based on their experience, training and education. Furthermore, based upon the strength or weaknesses of these elements, decision makers may employ heuristics and biases in the perception stage (Kahneman and Tversky, 1979). This model proposes that information and perception are interdependent as it is illustrated in Figure 4 by the double-ended arrow, and that judgment is a joint product of information and perception.

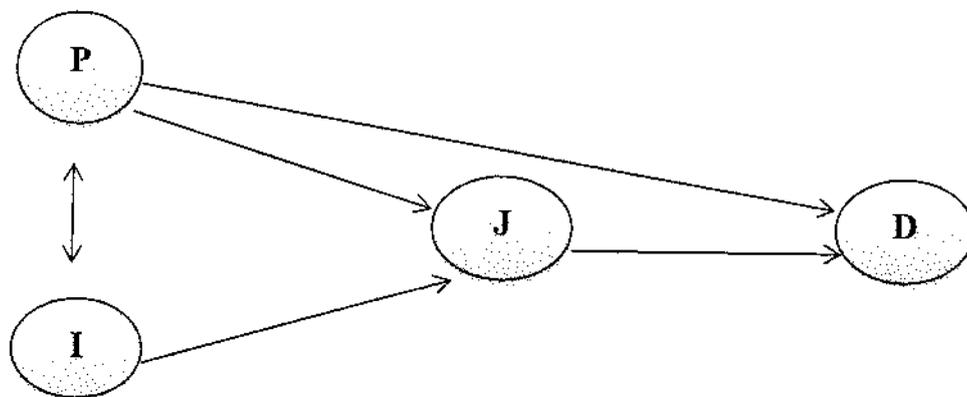


Figure 4 The throughput conceptual model

Source: Rodgers (1997) "Throughput Modelling: Financial information used by decision makers » JAI Press, Greenwich, CT.

4.3.2 The six critical pathways and related ethical theories

This model highlights six critical pathways (between the four components identified above) in the decision-making process while eliminating rival alternative hypotheses.

This model proposes matching these pathways with 6 theories of ethical behaviour. This will be defined and discussed below.

(1) $P \rightarrow D$. *Ethical egoism*. In this pathway, an action is considered ethically correct when it maximizes one's self interest (Rodgers and Gago, 2001; Rodgers et al., 2009). According to this reasoning, the decision is based upon the perceived circumstance, downplaying any relevant information and judgment. Thus, the decision maker's perception will directly influence the decision.

(2) $P \rightarrow J \rightarrow D$. *The deontology position*. In this pathway, the decision maker is committed to independent moral rules or duties, thus equal respect must be given to all individuals. Focus is on taking the right actions rather than on the consequences of the actions. In this pathway, rules and laws are framed and judgment (J) made by how the situation is perceived (P), before a decision is made (D).

(3) $I \rightarrow J \rightarrow D$. *The utilitarian position*. This pathway emphasises the maximisation of the good and the minimisation of harm to a society. Therefore, available information (I) is used in an objective manner throughout the analysis (J) before a decision is made (D). The decision maker's perception (P) is not considered.

(4) $I \rightarrow P \rightarrow D$. *The relativism position*. This pathway considers ethical standards based on the decision makers themselves or people around them. In this light, ethical beliefs are not absolute but depend on circumstances. Therefore, available information (I) will influence individual perception (P) before a decision is reached (D).

(5) $P \rightarrow I \rightarrow J \rightarrow D$. *The virtue ethics position*. This pathway doesn't consider what makes a good action but rather focuses on what makes a good person. Perception (P) will thus influence the selection process of the information (I) (ensuring that the selected

information is consistent with being a good person) which leads to the judgement stage (J), *en route* to a decision (D).

(6) $I \rightarrow P \rightarrow J \rightarrow D$. *The ethics of care position*. This assumes that people are willing to listen to distinct and previously unacknowledged perspectives. Thus all the relevant information (I) is considered and it influences perception (P). The resulting perceptions are analysed in a judgment (J), *en route* to a decision (D).

4.3.3 The Throughput Model in an auditor client negotiation context

Understanding the role of different components used by negotiators in their decision process is critical to understanding the decisions of negotiators. The TP model is proposed to describe the auditors' negotiation strategy selection process since its six dominant decision-making pathways relate to the foundation of the negotiation strategies.

The TP modelling approach allows for an analysis of the potential effects of auditors' perception of their negotiation situation on their decision choice of a particular negotiation strategy. This is important because parties to a negotiation engage in the negotiation as they perceive it rather than from some objective view.

The following discussion clarifies the operationalization of perception (P), information (I), judgment (J) and decision choice (D) in a negotiation context. These components are also summarised in Table 1.

Perception (of contextual features). These are conditions, biases or any other factors that can influence how the auditors interpret negotiation situations. This covers what Gibbins et al. (2001) referred the "antecedent conditions", these include negotiators' experience, history and relationship. The contextual features are grouped according to

three main groups: the primarily external features (nature of the accounting and auditing standards, engagement risk, audit committee characteristics etc.), the primarily interpersonal factors which include the nature of auditor-client relationship, and the primarily “capabilities” factors which involves parties knowledge and skills (Gibbins et al., 2010).

Information

The information consists of the accounting issue under negotiation and any other objective facts that affect the negotiation process such as unaudited account balances and analysts’ forecasts. The negotiation issue may rise as a result of the auditor or the client’s actions, or even be due to an external issue such as the release of a new accounting standard.

Judgment

After receiving information related to the accounting issue in the first stage, parties interpret and analyse carefully the issue relying on the analytical techniques acquired from the auditing exercise. This will allow the choice of the most preferred alternative (Gibbins et al., 2001). The auditor then has to see if there is any overlap with the client’s preferred position and to what extent it is feasible to reach an agreement with the client.

Decision Choice

The decision choice refers to the selection of a negotiation strategy. At this stage the auditor chooses among a set of strategies (contending, conceding, compromising, or integrative) one strategy that they will use to negotiate the accounting issue with the client.

Table 3 Auditor client negotiation modelled in the Throughput Model

1. Perception	The auditor selects a negotiation strategy based on his perception of the accounting context: Engagement risk, bargaining power as well as perceived auditor client relationship.
2. Information	All the information relevant to the course of the negotiation; such as the information represented by unaudited balances, financial statements and financial ratios.
3. Judgement	Analysis of the potential alternatives available in order to determine a position on the issue by providing an independent estimate of the account balance, and detecting potential overlap between his situation and that of his counter party.
4. Decision	The auditor decides on negotiation strategy and tactics; concede, compromise, contend, integrate that enables him to reach his objective.

In negotiating, the first stage (see Figure 4) involves framing of the contextual features of the negotiation environment and this may include perceptual biases that the auditor might have regarding the client's environment and incentives factors as depicted by the engagement risk and client pressure. This stage also involves the use of information like unaudited account balances and any other information, internal or external that is judged relevant in the course of negotiation, and could affect the auditors' decision choice. The double-ended arrow connecting perception and information in Figure 4 represents this relationship. For example, the auditors' evaluation of the unaudited balance, analyst forecasts, as well as expected income may be highly correlated with auditors' perception of the contextual environment such as the engagement risk and client importance.

Next, in the judgment stage, the contextual features (P) and financial and non-financial information (I) are analysed and weights are placed on key information items. This gives the auditor the ability to develop and compare a wide set of alternatives given the

increased ambiguity of accounting standards and to select a strategy in the decision choice stage (D). Auditors employ investigatory and analytical tools to diagnose the cause of a problem. Both deductive and inductive reasoning are required for effective diagnosis as shown by the direct arrow leading from information to judgement in Figure 4. For instance, Rodgers and House1 (2004) state that “auditors employ investigatory and analytical tools to diagnose the cause of problem” as illustrated by the direct arrow from information to judgment in Figure 4.

4.4 Summary

The purpose of this chapter was to discuss decision- making process of auditors as negotiators. Therefore I first presented Judgment and decision-making (JDM) research in auditing and concluded that this current research is directly related to the effect of heuristics and biases in audit judgment.

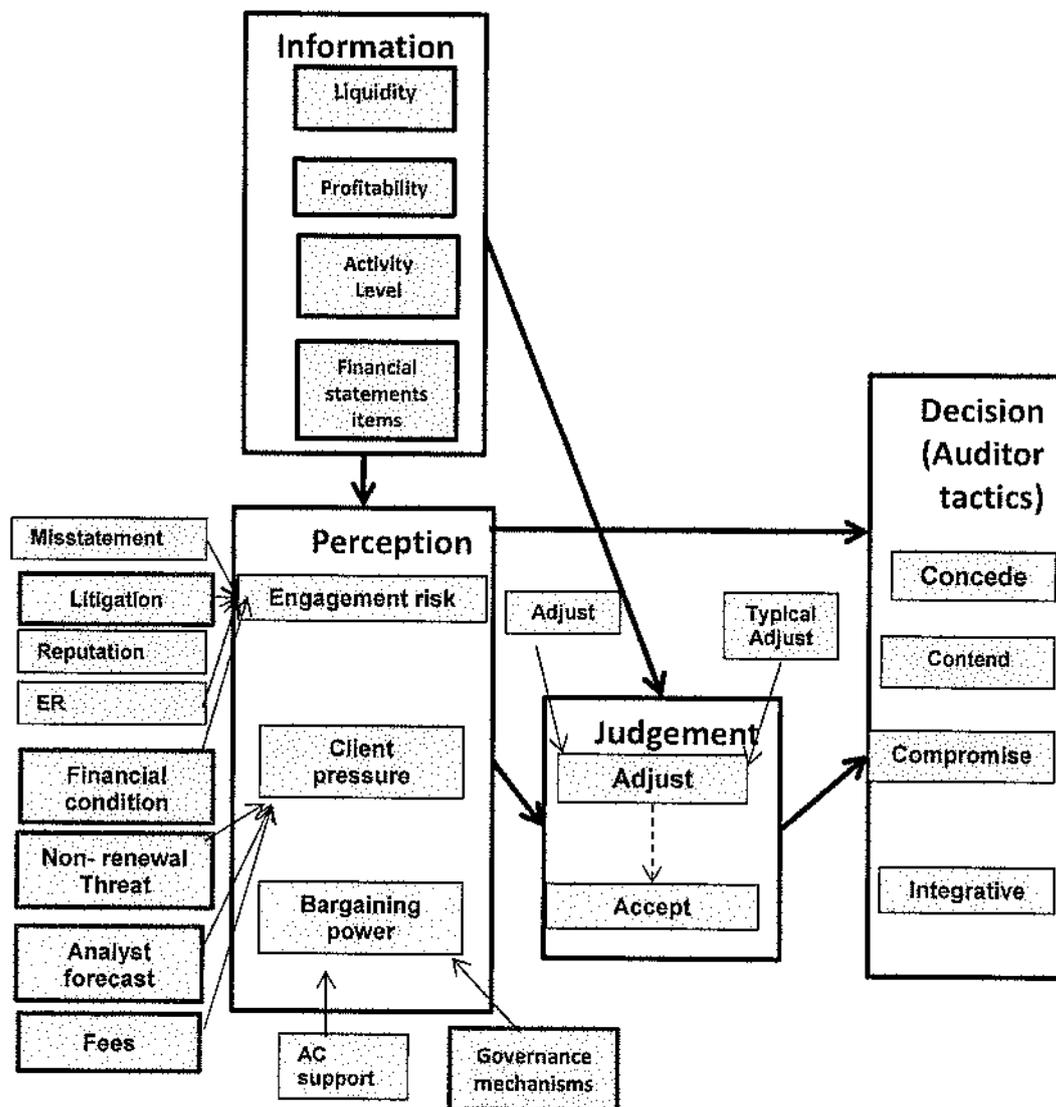
In the second part of this chapter I presented Rodgers (1997) model. This model emphasise the importance of developing accurate descriptions of the pathways used by decision makers. It acknowledges that decision makers do not intuitively act rationally, and identifies the systematic pathways in which decision makers depart from rationality as well as what could be expected from following a particular pathway (Foss and Rodgers, 2011).

One of the contributions of this thesis is the use of the Throughput model in auditor-client negotiation context. The TP modelling approach allows for an analysis of the potential effects of auditors’ perception of their negotiation situation on their decision choice of a particular negotiation strategy.

Chapter 5: Hypotheses development

5.1 Introduction

The following discussion illustrates the negotiation strategies that the auditor may select given the independent variables. The strategy choices are the dependent variables in this research. In this section, we discuss the effect of the variables of the conceptual framework of the auditor's choice in the light of the Throughput Model. We investigate three potential influences of perception of audit contextual features on the auditor's negotiation strategy: client engagement risk, client pressure and bargaining power besides the influence of financial information. These possible effects are the independent variables in this research. Figure 5 summarizes the theoretical model by illustrating how these variables are expected to have an impact both on auditor's negotiation strategy and his/her judgement about the extent s/he will accept management's alternative and the amount s/he requires to be adjusted by the client. (The Figure in the next page shows details about variable measures explained later). Then, we develop our hypotheses in detail.



CORPORATE GOVERNANCE – the CORPORATE GOVERNANCE as perceived by the auditor is measured by four items constructs and has 2 experimental conditions:

- The corporate governance mechanisms are strong;
- The corporate governance mechanisms are weak.

ENGAGEMENT RISK – the engagement risk is: “the risk that the audit firm will suffer a loss via litigation, loss of reputation or costs exceeding fees” (AICPA 1983; Johnstone 2000, Belle et al 2002) is measured by three items constructs and has two experimental conditions:

- Auditor perceives client engagement risk as high;
- Auditor perceives client engagement risk as low.

CLIENT PRESSURE – Auditor’s Perception of Client pressure: is - Client importance and client’s ability to meet the analysts’ forecasts is measured as three items constructs and has 2 experimental conditions:

- Auditor perceives client pressure as high;
- Auditor perceives client pressure as low.

ACCEPT: likelihood of accepting the accounting alternative of management

ADJUST: The amount required to be adjusted by client management

FI: company’s financial ratios

AUDITOR TACTICS – Auditor’s Intended Use of Tactics: the auditor’s decision about the negotiation

Figure 5 Model of auditor’s negotiation strategies decision choice

5.2 Financial Information

Previous research suggested that the client's financial condition influences auditor's engagement risk assessment. The probability of the auditor suffering from loss resulting from an engagement is found to be positively related to the financial condition distress (St. Pierre and Anderson, 1984; Palmrose, 1987; Schipper, 1991; Stice, 1991).

The findings of Asare et al. (1994) study reveal that audit partners perceive that the client's business risk as represented by financial conditions and the audit risk as represented by inherent risk and control risk determine their perception of the engagement risk. Similarly, poor financial performance of the client may result in a non-payment of the audit fees, which affects the auditing firm profitability and cash flows therefore its engagement risk. Furthermore, client's business risk is found to have serious legal consequences on the auditing firm.

As explained earlier, the Throughput model suggests that information (I) influences perception (P) and judgement (J). Therefore, the financial information as represented by profitability, liquidity and financial statements items may be highly correlated with auditor's perception of the engagement risk, and with the likelihood of acceptance of the management's alternative and the adjustment amount required by auditors. Thus, we posit the following hypothesis:

H1a: Positive financial information influences negatively auditor's perception about firm's engagement risk.

H1b: Positive financial information influences negatively auditor's judgement about the likelihood of rejection of management's alternative and the amount to be adjusted.

5.3 Engagement Risk

The auditor's perception of the client engagement risk is called RISK in most of our discussion. This represents the auditor's perception of the engagement risk. That perception is considered as a notable characteristic of the auditing environment (Bell et al., 2002). It is the "risk the audit firm is exposed to, and it involves the potential loss of, or injury to the professional practice from litigation, adverse publicity, or other events arising in connection with the audited financial statements" (Brown and Johnstone, 2009:78) . Auditors understandably want to keep this risk as low as possible and the most effective way of doing this, is by refusing to give in to clients' aggressive financial reporting attempts. The more conservative the financial statements endorsed by the auditors are, the lower their exposure to litigation or adverse publicity.

In this light, when the engagement risk is high, the auditor is constrained by the fear of losing his reputation and the need of preserving his job (losing present clients and becoming less competitive in bidding for future clients). In this context, Hackenbrack and Nelson (1996) found that auditors tended to resist the client's wishes and favoured more conservative financial reporting where engagement risk was high rather than where it was moderate. Similarly, Chang and Hwang (2003) found that risks related to potential litigation resulted in a reduction in auditors' willingness to accept aggressive auditees preferred alternatives.

On the other hand, Zhang (1999) presented an analytical model of the auditor's decision to accept an auditee preferred option as a decreasing function of litigation risk. In other words, the higher the engagement risk is, the less auditors accept client's position.

Conversely, Brown and Johnstone (2009), by using an experimental study with 60 auditors, examined the effect of auditor business risk on auditor-auditee negotiation

outcome. They showed that risk degree affected the negotiation process, and auditors rather use a concession strategy and achieve an aggressive negotiation outcome when the risk is high.

The authors argued that an alternative explanation of the influence of engagement risk on auditor decision making can be generated from motivated reasoning which suggests that this judgment might be driven by decision makers' motivation to achieve a specific conclusion without considering negative consequences that might occur (Kunda, 1990; Kadous et al., 2003). Therefore, decision makers tend to put more weight on evidence that is in line with their preferred position, this is confirmed by Kadous et al. (2003) who have found that motivated reasoning affects the objectivity of auditors, especially when they considered that the client's preferred alternative is the most suitable accounting treatment when the engagement risk is high. Therefore, we posit that engagement risk perception will influence the likelihood of auditor rejecting the client's proposed accounting policy and the requirement of audit adjustment in order to find the accounting to be in accordance with GAAP (J), which in turn influences their decision to adopt negotiation strategies that are consistent with achieving those goals (D). Furthermore, auditor engagement risk perception may influence directly negotiation strategies decision choice.

Hence we build our hypothesis following the Throughput sequence. In the first stage, perception influences judgement then in a second stage both perception and judgement influence decision.

H1c Engagement risk perception influences negatively the judgement of rejecting aggressive client accounting policy choices and the requirement of audit adjustments to bring the client accounting treatment into conformance with GAAP. This means that if

the engagement risk is high then auditors are less likely to reject aggressive accounting treatments and vice versa.

Then in the second stage and as suggested by the Throughout Model Perception and Judgement will influence auditor's decision of negotiation strategy choice.

H1d Greater acceptance of client alternative is more likely to result in the auditor employing conceding tactics and less likely to result in contending tactics.

Generic negotiation research has shown that negotiators use more integrative strategies when they are in a difficult situation with both high self-interest and concern for the opposite party (Pruitt and Carnevale, 1993). In this context, it is well known that auditors aim to please the clients in order to preserve their job and therefore s/he has interest of allowing them to achieve an acceptable position while staying within the GAAP boundaries. Hence, when an auditor is dealing with a risky client and does not see the usefulness of contending, s/he will make more effort to resolve the disagreement, which is the essence of integrative strategies. Therefore, we hypothesize:

H1e Greater acceptance of client alternative is more likely to result in the auditor employing integrative strategies.

Finally, because the client and the auditor have both their specific preferences with regard to the appropriate accounting treatment, both parties have interest and are prepared to move from their initial preferences. Thus, we suggest that auditors propose a compromise when the engagement risk is high.

H1f Greater acceptance of client alternative is more likely to result in employing compromising strategies.

On the other hand, we suggest that engagement risk perception leads directly to the negotiation strategy choice, hence we posit the following hypothesis:

H1g Greater perceived engagement risk is more likely to result in auditors employing conceding tactics, compromising strategies and integrative strategies but less likely to result in contending strategies.

5.4 Client pressure

Auditors are often faced with clients who are trying to put pressure on them in order to waive the audit adjustments and to accept their accounting treatment preferences, mostly by threatening them with non-renewal of their contract (Teoh, 1992). However, professional standards provide guidance for auditors on how to respond to client pressures, and most of the ethics chapters of auditing textbooks provide the expected attitude for such threats (Knechel et al., 2007). Therefore, auditors are more likely to withstand explicit pressure and more likely to reject client's aggressive accounting treatments, thus the conceding strategy is not an option in this situation. In this light, Kadous et al. (2003) found that client pressure affects the auditor's accepting client's position, specifically auditors in their sample indicated that the client's alternative is the most appropriate alternative when they are faced with high client pressure.

Given that auditors have no means to concede as explained previously and no means to contend due to the high client pressure, auditors may attempt to influence the client's management by facilitating the management's focus on how their interests converge. In this case the auditor is willing to move from their initial position and expect the same from the clients; (s)he might therefore use compromising strategies in order to achieve an acceptable outcome.

Furthermore, based on reciprocity theory of negotiations (Pruitt and Carnevale, 1993; Lewicki et al., 2003), auditors will interpret the client pressure as a contending strategy, therefore they will react to this position by compromising strategy (i.e. which

is the second best choice for them) as they are in a weak position as explained previously. This suggests the following hypotheses:

H2a: Greater perceived client pressure is less likely to lead to a rejection of aggressive client accounting policy choices and to the requirement for larger audit adjustments to bring the accounting treatments into conformance with GAAP.

H2b: Higher acceptance of management's alternative is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship).

H2c: Greater perceived client pressure is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship)

5.5 Bargaining Power

Our second theoretical variable is the bargaining power (POWER) which represents the the auditor's perceived likelihood of succeeding in the negotiation (Gibbins et al., 2001). Differences in bargaining power explain variation in the strategies adopted by negotiators. We expect that more powerful actors are more likely to opt for hard bargaining tactics than less powerful ones, since hard bargaining can undermine relations between parties (Lax and Sebenius, 1986). Therefore, actors who do not fear such deterioration of relations should use hard bargaining more frequently. Hard bargaining tactics make sense for an auditor who does not fear termination and thus in a position to implement their choices.

Bargaining power is influenced by the accounting and auditing environment (e.g. audit committee strength, corporate governance mechanisms, accounting standards, etc....) as well as by parties' abilities and skills (e.g. experience and expertise). In this context Ng and Tan (2003) suggest that audit committee strength and authority guidance

mechanisms enhance auditor's bargaining power. Furthermore, Brown-Liburd and Wright (2011) found that auditors employ more contending tactics when the audit committee is strong, which indicates that auditors use more hostile tactics when they perceive they have the support of the audit committee.

Therefore, we posit the following hypothesis in the light of the Throughput model, Perception influences Judgement in a first stage and then in a second stage, both Perception and Judgement influence negotiation strategies decision choice.

H3a Greater perceived bargaining power is more likely to lead to a lesser willingness to accept aggressive client accounting policy choices and to the requirement for higher adjustments to client accounting to bring the financial statements into conformance with GAAP.

In the event of weak corporate governance, auditors are motivated to avoid contentious situations since they do not expect support from the audit committee. In such situations, auditors are more likely to use the concede strategy, which is expected to offer more advantages to the opposite party as compared to the initiator. Consequently, we suggest that:

H 3b Higher acceptance of the management alternative leads to conceding negotiation strategy.

H 3c Weak perceived corporate governance leads to conceding negotiation strategy.

Figure 6 below provides for a graphical representation of the research hypotheses.

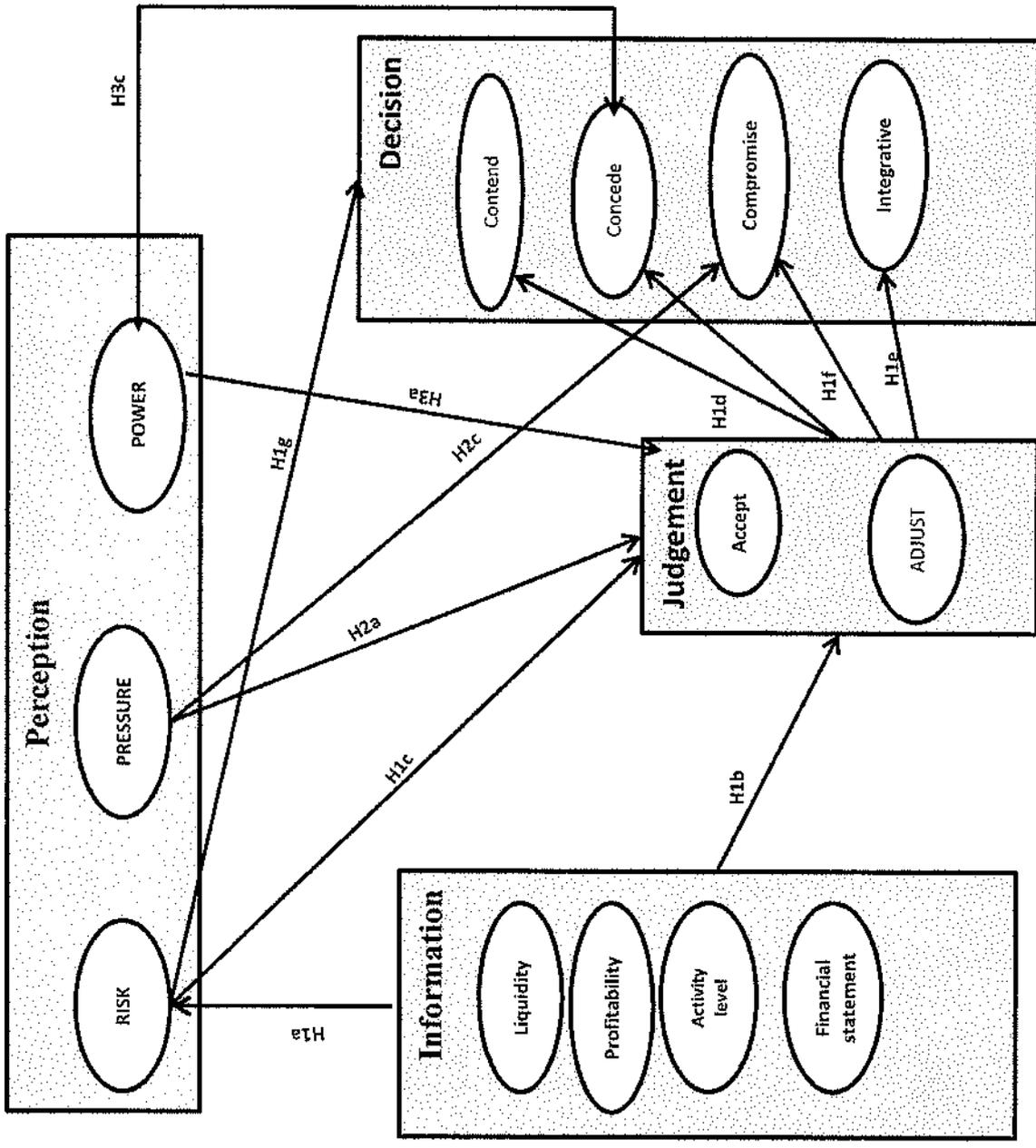


Figure 6 Presentation of the research hypotheses

5.6 Hypotheses summary

The table below provides a summary of the research hypotheses.

Table 4 Research hypotheses summary

Independent Variables	Pathway	Hypotheses	Findings
Engagement Risk			
	I→P	H1a: Positive financial information influences negatively auditor's perception about firm's engagement risk.	Not supported
	I→J	H1b: Positive Financial information influences negatively auditor's judgement about the likelihood of rejection of management's alternative and the amount to be adjusted.	Not supported
	P→J	H1c: Engagement risk perception influences negatively the judgement of rejecting aggressive client accounting policy choices and the requirement of audit adjustments to bring the client accounting treatment into conformance with GAAP.	Supported
	J→D	H1d: Greater acceptance of client alternative is more likely to result in the auditor employing conceding tactics and less likely to result in contending tactics.	Supported
		H1e: Greater acceptance of client alternative is more likely to result in the auditor employing integrative strategies.	Supported
		H1f: Greater acceptance of client alternative is more likely to result in employing compromising strategies.	Supported
	P→D	H1g: Greater perceived engagement risk is more likely to result in auditors employing conceding tactics, compromising strategies and integrative strategies but less likely to result in contending strategies.	Partially Supported (direct effect on integrative strategies only)

Client pressure

P→J	H2a: Greater perceived client pressure is less likely to lead to a rejection of aggressive client accounting policy choices and to the requirement for larger audit adjustments to bring the accounting treatments into conformance with GAAP.	Not supported
J→D	H2b: Higher acceptance of management's alternative is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship).	Not supported
P→D	H2c: Greater perceived client pressure is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship)	Supported
<hr/> Bargaining Power <hr/>		
P→J	H3a: Greater perceived bargaining power is more likely to lead to a lesser willingness to accept aggressive client accounting policy choices and to the requirement for higher adjustments to client accounting to bring the accounting into conformance with GAAP	Not supported
J→D	H 3b: Higher acceptance of management alternative leads to conceding negotiation strategy.	Not supported
P→D	H 3c: Weak perceived corporate governance leads to conceding negotiation strategy.	Supported

CHAPTER 6: Research Methodology

6.1 Introduction

The purpose of this chapter is to discuss the methodology choice of the current research. It also illustrates how the research was pursued. Briefly, this was based on a careful examination of the literature review and the conceptual framework, which allows achieving the research objectives and resolving the research questions. At the beginning, the assumptions and philosophical stance of the research were reviewed to recognise the relationships and rationalisation of the selected approach. This discussion covers the selection of the research strategy and its validation for theory testing. This chapter also illustrates how the research hypotheses were empirically tested (i.e. data collection methods, experiment design and analysis technique adopted).

This chapter ends with presenting in detail the research design used in the current study, starting with a description of the case setting, the description of the study's variables and their measurement. I adopted The Throughput model framework, which, entails that judgement (i.e. the acceptance of management alternative and the amount required to be adjusted) represent the independent variables for negotiation strategies decision choice in the second stage.

6.2 Philosophical Stance of the Research

Research philosophy is concerned with 'the development of the knowledge' (Saunders et al., 2011). According to Easterby-Smith (1991), it is essential to identify the research method, the research strategy to be adopted as well as data collection methods that best

answer the research question(s). Consequently, understanding research philosophy is fundamental to effectively choosing the best research method that answers the research problem. Furthermore, the philosophical underpinning of research shed light on the limitations of a particular research area and enables researchers to control aspects of research and come up with original ideas. Tashakkori and Teddlie (2010) suggest that a research paradigm represents all the beliefs that surround theories in a particular research area. The objective of the research paradigm is to understand the relevant research methods and the different interpretations within a particular research field. Particularly, it clarifies the way a research study should be carried out and explains how we drive inferences from the results (Bryman, 2004).

In this context, Positivism and interpretivism are the two competing research paradigms (Saunders et al., 2011). Specifically, the positivist paradigm is considered as a scientific, objectivist and quantitative approach, dealing essentially with causal laws; on the other hand, the interpretivism paradigm is considered as anti-positivist. Researchers have asserted that neither of the two paradigms is better than the other, and that they both have advantages and disadvantages. Furthermore both paradigms have been able to guide the main concerns of carrying out a research (Creswell and Clark, 2007; Saunders et al., 2011). In what follows, the main assumptions of the research philosophies will be discussed.

6.2.1 Ontology

Ontology involves the study of the existence and is concerned with the construction of the reality. Bryman (2004) has stated that ontology covers the structure of the world, the truth, the nature of being, and reality. Therefore, the questions that ontology attempts to

answer are rather 'what is the extent of the external reality existence?' instead of 'what is the theory behind the truth'? And 'how existence can be understood?'

Saunders et al. (2011) have discussed ontology in relation to the human thought positioning towards social and natural reality and have identified two aspects, namely objectivism and subjectivism/idealism. Objectivism considers that social and natural reality exists outside of human thoughts, beliefs and conceptions, therefore, research and social phenomena are independent from each other. On the other hand, subjectivism/idealism assumes that social actors' perceptions create social phenomena; hence the truth depends on the individuals' point of view which results in different versions of the truth. Therefore, absolute truth does not seem to exist and it is considered as human conception.

6.2.2 Epistemology

Epistemology is considered as a theory of knowledge (Johnson and Duberley, 2000). It seeks to build the set of knowledge and the theories related to a research area. In other words, it is concerned with the organisation of the knowledge related to theories (Johnson and Duberley, 2000). Johnson and Duberley (2000) suggest that epistemology introduces all the assumptions that have justified the beliefs concerning social phenomenon. Thus, it should begin with arguments before achieving the knowledge that justifies these arguments (Saunders et al., 2011). In this context, the positivists view the development of knowledge as a cumulative process of developing and testing hypotheses (Burrell and Morgan, 1979). Whereas, anti-positivism holds a different point of view and considers that knowledge can only be acquired by the direct involvement of researchers in the investigated activities (Saunders et al., 2011).

6.2.3 Axiology (Judgment about Value)

Axiology is concerned with judgements about value (Saunders et al., 2011). Since individual actions are guided by their values, it is expected that these values will be reflected throughout the research process. Saunders et al. (2011) suggest that judgements about the research topic and research method are influenced by researchers' values. Indeed, it is a manifestation of their axiological expertise. For example, using surveys instead of interviews shows that human interaction is not valued by researchers compared to the access of large data set. Understanding the values and their impact on the research improves research quality as it minimises research bias and increases its transparency.

6.2.4 Positivist Philosophy

Positivism is considered as the dominant research philosophy used by natural and some social scientists, since it deals essentially with truth and reality. This research adopts the scientific way of investigation (Neuman, 2002). In this context, positivism refers mainly to quantitative data collection from human point of view and actions by examining scales, and frequencies of occurrence of the investigated issue (Collis et al., 2003).

Neuman (2002) states that with positivist approach theories, variables, hypotheses and numbers are set in a consistent way with the selected technique of data analysis. Furthermore, he suggested that careful, accurate measures along with objective research are pursued and cause-effect hypotheses are carefully assessed based on the facts through the adopted measures.

The objective of quantitative research is to explain and predict phenomena occurring in the social world. Therefore, it analyses relevant incidents in order to achieve an appropriate justification for the prediction of these phenomena (Neuman,

2002; Saunders et al., 2011). This research method is widely used within positivist paradigm (Collis et al., 2003). For positivists, data is objective, therefore they assume that human perception does not influence the external world, which is at very essence of quantitative measurement (Saunders et al., 2011).

In order to view social reality, researchers use a scientific method for collecting data, which is analysed and interpreted statistically (Bryman, 2015; Tashakkori and Teddlie, 2010). Researchers have acknowledged that the philosophical position is reflected in the research method choice. In this context, two research methods are in use, namely deductive which is concerned with testing theory and inductive which is concerned with theory building (Easterby-Smith, 1991). The positivists consider science as a process of testing and justifying idea in order to understand complex phenomenon, whereas subjectivists focus on the interpretation of social actions.

The objective of positivism is to develop laws and rules under which institutions operate (Johnson and Duberley, 2000; Creswell and Clark, 2007). Further, Johnson and Duberley (2000) have claimed that cause-effect relationships result in a more scientific approach that enables practitioners and researchers to predict and control their environment. The paradigm choice shows that research methods depends on research circumstances (Creswell and Clark, 2007) therefore it is essential to understand methodological paradigms before selecting a particular research method.

Audit judgement decision-making research is originated from the judgment and decision-making stream of psychology research and is greatly influenced by the positivist scientific approach; consequently, the current study has adopted a positivist approach.

6.2.5 Interpretivism Paradigm

The interpretivism paradigm has emerged since the early 1960s due to the positivist philosophy limitations; Particularly the lack of reliable statistical software (Sekaran and Bougie, 2010). Scholars have acknowledged different interpretations of social phenomenon, which is considered as a form of belief that cannot be avoided (Neuman, 2002; Bryman, 2015).

According to Neuman (2002), individuals have different interpretations for the same text. In fact, they develop strong opinion about social phenomenon and their views are usually manifested in text interpretations. Furthermore Johnson and Duberley (2000) have recognised that the true meaning is not directly observed. Consequently, researchers use interpretive explanations to connect different parts of the research in order to achieve an acceptable understanding of the problem under investigation.

This research paradigm, called qualitative research, uses exploratory data collection, observation and field research when studying human behaviours within organisations (Neuman, 2002). This results in a costly research process due to the considerable time allocated to the research process and to the difficulty of access to respondents. However, this paradigm offers many advantages, for instance, it emphasis human actions in the research process (Denzin and Lincoln, 2011).

In conclusion, although the paradigms mentioned above have mutually exclusive philosophical underpinning, they have both advantages and disadvantages and their use should be carefully justified (Easterby-Smith, 1991; Saunders et al., 2011).

6.2.6 Pragmatist Paradigm

Bryman (2011) suggests that quantitative and qualitative paradigms can be integrated in one research paradigm: the pragmatist paradigm, this paradigm resolve research's complexity issues. In this line pragmatists use both qualitative and quantitative approaches (Tashakkori and Teddlie, 2010). The joint use of the research approaches may improve the research results. It is worth noting that the use of a pragmatic approach should have an epistemological justification, which is mostly the pluralist aspect that enables researchers to deal with complex issues (Saunders et al., 2011).

When combining qualitative and quantitative methods, data is cross validated which improves data accuracy and authenticity (Tashakkori and Teddlie, 2010; Creswell and Clark, 2007). Moreover, mixed-methodology has proved its effectiveness when dealing with multifaceted research issues.

6.3 Research Approach and methodology

Saunders et al. (2011) distinguish between deductive and inductive approaches. In this context, the deductive approach is usually associated with positivism whereas the inductive approach is associated with interpretivism. However, this labelling should be taken with care due to philosophical arguments according to Saunders et al. (2011). These two research approaches will be discussed below.

6.3.1 Deductive Approach: Theory Testing

A deductive approach extracts causal relationships among the variables of the study from existing theories. This requires a rigorous review of the theories to develop hypotheses and then collect quantitative data in order to test these hypothesis (Easterby-Smith, 1991; Saunders et al., 2011; Bryman, 2015). Thus, it is logic that this approach is

the dominating research approach within natural sciences since it aims to develop laws that predict phenomena and try to control them (Collis et al., 2003; Bryman, 2015).

In order to test the developed hypotheses, researchers using this approach use quantitative data. Furthermore, the main idea of this approach is the generalisation of the findings. In fact, researchers seek to generalise findings from a particular sample to the whole population of the study.

6.3.2 Inductive Approach: Theory Building

According to Yin (2009), an inductive approach involves exploring individuals experiences and understandings through interviews. The key idea of this approach is theory building (Sekaran and Bougie, 2010; Saunders et al., 2011). This is the approach that interpretivists usually use to find a case, observe situations, generate relationships, and develop theories (Easterby-Smith, 1991; Saunders et al., 2011).

6.3.3 Research Approach of the study

After a detailed investigation of the research approaches used in prior studies, a deductive approach has been selected to answer the research questions of the current study, particularly by using experimental methods. It involves the construction of a conceptual framework and the development of research hypotheses. The deductive approach helps to achieve building the conceptual framework and generate the hypotheses from existing literature (Creswell and Clark, 2007; Saunders et al., 2011).

This thesis follows the hypothetico-deductive tradition of audit judgement decision making research for scientific explanations (Chua, 1986). Hypotheses are derived from auditor-client negotiation research fit in decision-making and then tested under experimental control.

6.4 The choice of quantitative methodology

The aim of the deductive approach and quantitative method is to prove and confirm the generated hypotheses through rigorous scientific procedures. Indeed, they are used to assess to what extent the developed propositions derived from the literature are valid (Tashakkori and Teddlie, 2010). In this context, Collis et al. (2003) suggest that quantitative research enables the validation of reviewed theories which usually contains many variables. In addition, quantitative methodology is carried out to generalise the findings to the whole population under study (Neuman, 2002). It is worth noting that this methodology has been used widely by social sciences researchers since it predicts causal relationships between variables in a simple way (Collis et al., 2003).

In order to achieve the aim of this research, which is identifying and understanding the impact of audit contextual factors on the auditor-client negotiation strategies, quantitative methodology was felt appropriate as it ensures objectivity by collecting numerical figures and analysing them statistically to reach relevant conclusions (Neuman, 2002).

The contextual features (i.e. engagement risk, client pressure, bargaining power), are examined as independent variables, along with the likelihood of accepting the client proposition and the amount to be adjusted; while negotiation strategy choice is the dependent variable.

Importantly, auditor- client negotiation studies carried out so far are mainly quantitative theories testing using mostly experiments, therefore the present research has adopted the quantitative methodology to address research questions. The explanatory nature of this study, with its fundamental objective of identifying the impact of auditors' perceptions about audit contextual features, justifies the choice of the quantitative approach (i.e.

experiment to identify the impact of contextual features on the negotiation strategies choice).

Previous studies have demonstrated that experiments gives reliable information about the impact of auditor's perceptions of contextual features on the negotiation strategies. Following previous research, quantitative research has been adopted in the present study. Further, quantitative research answers the nature of questions of quantitative research are: "what, when, where, who." (Saunders et al., 2011) which is the same nature of the present research.

6.5 Research Design

Creswell and Clark (2007) suggest that the research design enables the identification of the study concerns, for instance it identifies the study limitations, its context, scrutiny type and unit of measurement. Further Yin (2009) considers research design as a fundamental part of reliable and valid research. According to Cooper and Schindler (2001), the research design enables researchers to plan their research so it best answers the research questions. In this context, three main research design types can be identified i.e. exploratory, descriptive and causal or explanatory; these are presented in the following section.

6.5.1 Exploratory Research

Exploratory research involves essentially conducting investigation to obtain all the relevant information concerning the research questions. According to Neuman (2002), researchers start with the development of hypotheses before testing and validating them. Further Saunders et al. (2011) state that exploratory research is conducted to address the research problem with the minimum information available, therefore, exploratory

research design involves exploring original insights about propositions, this is particularly useful when the variables of the study are unknown to researchers (Creswell and Clark, 2007). Overall, it is an early stage of the research during which observations are gathered through reviewing the literature, subjective experts interviews and focus group interviews (Saunders et al., 2011).

6.5.2 Descriptive Research

Descriptive research is the phase during which the trends identified in the exploration phase are portrayed in detail to establish empirical generalisations. According to Denzin and Lincoln (2011), descriptive research depicts all the facets of the research problem, events, individuals or group, hence explaining the position of the affairs as they occur. In this light, surveys could be employed for this purpose. Most importantly, descriptive research focuses on the characteristics of the study variables rather than the relationship of these variables (Neuman, 2002; Saunders et al., 2011).

6.5.3 Explanatory Research

Explanatory research is the stage where theory is generated, tested and reformulated until validated or rejected; its main objective is to study the effect of the independent variables on the dependent variables. In fact, existing theories provide insights about the predicted relationships between certain variables, specifically the sign and the strength of these relationships. It is the role of the explanatory research to provide the appropriate measurements of the variables and to test the underlying hypotheses.

6.5.4 Suitable Research Design for the Current Study

Since the current study develops hypotheses based on existing theories and tests the causal relationships between variables, exploratory and explanatory research designs are

deployed to achieve these objectives. Precisely, exploratory research assist researchers in the identification of the research problem and in the development of the conceptual framework when existing research does not provide enough answers' keys to the research problem (Saunders et al., 2011).

The objective of explanatory research is to identify the association between the variables under investigation. As explained earlier, this study investigates the correlation among variables and develops the conceptual framework of auditor selection of negotiation strategies. Essentially, this research approach seeks to explain why a particular phenomenon happened using the results of descriptive research (Saunders et al., 2011).

The research questions and research objectives of the current study could be answered by exploratory and explanatory research as it first, develops hypotheses from existing theories to be tested and validated in a second stage.

The main objective is to examine the factors that affect auditor-client negotiation strategies. This would be possible by adopting exploratory and explanatory designs that help developing and testing cause and effect relationships between the constructs of the study. Further, a quantitative approach is employed to help answer the study's objective.

According to Peecher and Solomon (2001), the research approach depends on the existence of sufficient understanding of all the research facets in the existing literature. Although, there is a considerable literature of auditor-client negotiation studies, to our knowledge, there has been no research that ever brings the findings to judgement making decision research. This thesis is to push applicability of psychological perspectives particularly the Throughput model in an auditor-client negotiation context. Therefore, in the context of Peecher and Solomon (2001) typology, this thesis can be

considered as an exploratory study in the field of auditor- client negotiation and JDM research.

Structural equation modelling (SEM) has been used to test the relationship between the variables using Smart-PLS (Partial Least Square) technique. This technique applies a two-step approach. In a first stage, measurement model should be evaluated to ensure the reliability and validity of the latent constructs; before assessing the structural model and testing the developed hypothesis in a second stage.

6.6 Research Strategies

According to Neuman (2002); the nature of the research determines the research strategy carried out. Research strategies involve identifying the sources of the data collection that help in answering the research objectives. In this context, different research approach strategies can be adopted, mainly, experiment, survey, case study, action research, ethnography, archival research and grounded theory (Saunders et al., 2011). These will be discussed below.

6.6.1 Experimental Research Strategy

Experimental research refers to an empirical quantitative strategy under positivism, which develops knowledge by using essentially impartial and structured methods (Neuman, 2002; Sekaran and Bougie, 2010). Its fundamental concern is research hypotheses testing and for this reason, it is considered the dominant research strategy in natural sciences (Neuman, 2002).

This research strategy involves simply manipulating either the independent variable or experimental group following a particular programme (Saunders et al., 2011). Saunders and colleagues have pointed out that study variables should be measured properly in

order to identify the causal relationships. It is worth noting that this strategy ensures tests of cause and effect relationships (Neuman, 2002).

6.6.2 Survey Strategy

According to Neuman (2002), survey strategy offers a major gain regarding the amount of time while maintaining accuracy, validity and reliability of the results. However, this strategy can lead to biased results if not used properly. Usually, the questions that the survey strategy tries to answer are of the nature: who, what, how much and how many (Saunders et al., 2011). In this light, survey strategy is mainly used by descriptive and explanatory research designs (Johnson and Duberley, 2000). In order to explain the relationships between the study's constructs, data is usually collected through questionnaires or structured interviews.

6.6.3 Case Study

According to Yin (2009), a case study involves examining a phenomena within its real context. This is particularly useful when phenomenon and context cannot be easily distinguished from each other. This strategy is mostly used in qualitative research since it seeks to gather data and observe social units such as organisations, individuals or cultural groups. Creswell and Clark (2007) have stated that it allows studying issues extensively.

Case study focuses on investigating specific events or conditions and their relationships. According to Yin (2009), this research strategy involves a deep knowledge on a complex research area; this requires a detailed investigation of a specific issue with all the surrounding circumstances.

The questions that case study strategy is concerned with are “why” and “how” (Saunders et al., 2011). It is worth noting that social sciences have extensively used case studies to tackle research problems related to real- life circumstances.

6.6.4 Action Research

According to O'Brien (1993), action research is a strategy by which researchers learn by doing (i.e. they explore a particular issue and try to provide clarifications about it). This strategy is different from other research strategies from a philosophical view point as it is rather concerned with providing knowledge and learning at the same time, rather than testing hypotheses and providing empirical generalisations (Bryman, 2011). Action research is associated with joint self-reflective investigation by which researchers promote their rational and impartial social educational practices (Johnson and Duberley, 2000).

6.6.5 Ethnographic Research Strategy

Ethnography is a qualitative research that fundamentally describes individuals and their cultures (Neuman, 2002). In order to achieve this objective, researchers rely on a the thorough debate of the culture from the viewpoint of the insiders to ensure a proficient understanding of the phenomena under investigation. Different tools are available to collect data within this strategy, specifically direct observation, open-ended interviews and exploring available documents related to the study (Yin, 2009).

6.6.6 Archival Research

This research strategy is mainly performed in libraries and collections galleries. It is worth noting that social scientists use archives differently than historians and that they mostly seek to reconstruct the past patterns (Saunders et al., 2011).

6.6.7 Grounded Theory

Grounded theory is the process by which researchers build theory during the data collection stage, hence it is named grounded theory as the researcher grounds the theory from the available data. This offers more flexibility to the research and a significant interaction between data and theory (Neuman, 2002). It does not need a conceptual framework to start with, but it rather starts with gathering data from available observations (Saunders et al., 2011). The main advantage of grounded theory is that the research problem remains open to changes. In fact, researchers can amend the orientation of the investigation or in certain cases drop out the first research problem in the course of the research process if novel insights are discovered (Neuman, 2002).

6.6.8 Why Experiment Strategy?

Given the explanatory nature of this research, an experimental method is found most suitable to answer research questions. It has to be noted that experimental design in the field of social sciences is often criticized with regard to realism (Hogarth, 1993; Peters, 1993). Especially, experimental research is unlikely to incorporate the complex real-world setting without altering results validity. The following paragraph addresses in detail the issue of realism in audit judgment research.

6.6.8.1 The issue of realism in experimental studies

Since 1980s, the issue of realism has been considered as the major limitation of experimental studies in audit and accounting research. Moreover, the strength of the findings has been always challenged. In this context, Swieringa and Weick (1982), identified two types of realism: namely mundane realism and experimental realism. Mundane realism is concerned with the association of the events represented in the laboratory with the events in a real world. Experimental realism involves considering

whether the laboratory setting is sufficient and valid, especially whether participants take seriously the laboratory events (Swieringa and Weick, 1982).

It is worth noting that audit researchers should be concerned with the issue of mundane realism, as experiments developed in audit judgement decision making mostly deploy settings detached from real situations, therefore they may not reflect the reality about audit judgement.

Peters (1993) considers relying on simple experimental studies and using statistical analysis to validate research hypothesis as a major threat to the research validity. It is fundamentally the empirical generalisation of the laboratory setting's findings to the real audit decision making context that brings into question the robustness of the experimental strategies (Hogarth, 1993).

Swieringa and Weick (1982) reviewed more than 100 experimental studies published in major accounting journals (i.e. Accounting, Organizations and Society, The Accounting Review, and the Journal of Accounting Research) and they concluded that the findings of those studies are relatively weak and usually conclude with statements like "some do, some don't, the differences are very great, and it's more complicated than that" (Swieringa and Weick, 1982:56).

Gibbins et al. (2001) have further advanced that the richness of the study context affects the robustness of audit studies. It is worth noting that psychologists and economists excel in abstracting the reality from the applied setting, while accountants perform better when understanding the applied setting.

The criticism related to mundane realism is linked to omitting a substantial set of factors from the reality to increase the control of the case setting. In this context, Peecher and Solomon (2001), have a different point a view. They argue that the simplification of the

real world and the task results in the success of the experimental setting, for them mundane realism is not a necessary and sufficient condition for internal or external validity, stating that increasing external validity at the expense of internal validity might be a big mistake.

Another issue that limits the access to real life information is the significant complexity of audit judgment and the reticence of participants to reveal their opinions, this makes testing full theories statistically challenging which restricts their empirical generalisation and their associated external validity, therefore verification and discovery are more problematic and less informative.

Swieringa and Weick (1982) argue that experiments enable discovery and theory development as researchers can create conditions that never existed and investigate what happens if these conditions are satisfied. Moreover, they see experiments as a clean test of theory and that random sampling issues, always present in audit research, can be an advantage as it is the theory that enables the generalisation across research population and contexts; therefore the simplification related to empirical setting turns into an advantage for the research (Swieringa and Weick, 1982).

According to Peecher and Solomon (2001), in order to ensure external validity, it is better to use professionals as participants. In this context using students as surrogates has been considered a mistake, especially with regard to mundane realism issues (Swieringa and Weick, 1982). However, the access to professionals is usually difficult; therefore, the use of students in experimental studies is becoming more common given its practicality especially for financial considerations. More importantly, they emphasise that researchers need to compromise on certain points. Although students' characteristics are unlikely to be similar to those of practitioners, the effectiveness of

using them as surrogates is subject to empirical validation and depends on the research context and the empirical case. Therefore, researchers need to identify the essential features that affect the validity of experiment findings. In this light, the empirical investigation (Abdel-Khalik, 1974; Ashton and Kramer, 1980; Gordon et al., 1986; Liyanarachchi and Milne, 2005) of the effectiveness of using students as surrogates has not been conclusive about whether psychological properties judgement can override surrogate weaknesses such as skills and experience.

According to Hodge (2001), Libby et al. (2002) and Liyanarachchi (2007), accounting students have similar cognitive structure to these of practitioners. Libby et al. (2002) have acknowledged that students can be appropriate in general cognitive abilities research. Researchers should combine a large set of studies related to one research area in order to achieve mundane realism (Liyanarachchi, 2007). It is therefore essential to make replications of the original study to different samples in order to generalise findings to the whole population, this would not be possible without using students due to the difficulty of access to professionals.

6.6.8.2 Experiment and quasi-experiment method

The majority of auditor-client negotiation research uses mostly experiments where data is collected and analysed for different groups on a specific task. This research follows the hypothetico-deductive approach adopted by this line of research.

According to Kothari (2004) experimental designs involves the control of the research context, the manipulation of the variables of interest (independent variables) and studying their effect on the outcome variables (dependent variables). Therefore, it is considered as the most robust method to examine cause and affect relationships between constructs.

It is essential for researchers in a true experiment to assign randomly participants to different groups; however, in audit judgement decision making researchers are mostly interested in a particular group of subjects with specific qualifications and characteristics; therefore, random sampling is not appropriate in audit JDM research.

6.7 Data Collection

Two types of data collection methods are available to researchers, namely primary and secondary data (Bryman, 2011; Saunders et al., 2011). Primary data is collected for the purpose of a specific research problem. It can be quantitative using questionnaire and structured interviews or qualitative using structured and semi- structured interviews, focus groups, observations and case studies. On the other hand secondary data is accessible for the researchers and consists of untreated data and disclosed reports (Saunders et al., 2011).

The sample size should be selected carefully as it impacts upon the reliability of the results. It should not be too small as it may compromise convergence, solution appropriateness and accuracy of the research measurements (Hair Jr et al., 2016). In addition, the sample size should not be very large as it results in increased costs and in a long process to secure data (Bryman, 2011; Hair Jr et al., 2016). Therefore, the current study has followed the recommendations of the data analysis technique adopted (i.e. structural equation modelling (SEM) using PLS). As suggested by previous literature, the SEM model fit depends fundamentally on the size of the sample. This should be chosen in a way that ensures statistical convergence, power and accuracy of the constructs (Monecke and Leisch, 2012; Hair Jr et al., 2014). Garson (2012) has suggested that the sample size should be between 100 and 200. Kline (2011) has further added that a sample size below 100 would not be appropriate for PLS models.

The research subjects in the study reported in this thesis comprised of a mix of professionals having work experience in audit attending an audit course in an accredited American university. These are used as surrogates for audit partners given the difficulty of access to these professionals. As discussed above using students as surrogates of practitioners is common in experimental studies in audit. Therefore, using accounting professionals having working audit experience should be even better. In addition, complexities of real practice were removed from the experimental material to represent the actual characteristics of audit partners. Using survey tools, this thesis designed a paper and pen based experiment using questionnaires which will be presented in detail in the following section.

6.8 Research method

To test the research hypotheses, and according to the description in Figure 5 a 3 x2 experimental design has been implemented, with independent variables e.g. RISK, PRESSURE and POWER. Dependent variables were the auditors' choice of negotiation strategies, their willingness to accept management's alternative, along with the amount required to be adjusted. The Throughput model framework entails that judgement (i.e. the acceptance of management alternative and the amount required to be adjusted) represent the independent variables for negotiation strategies decision choice in the second stage. In what follows, the research design will be presented in detail, starting with a description of the case setting, the description of the study's variables and their measurement.

6.8.1 The case setting

The current study used a case based on Kleinman and Palmon (2000)'s published case which portrays a concrete auditor-client negotiation case and I made some changes to

the original case since it was published but importantly, to include the specific issues I targeted in my study. The subsequent case and related instrument were created after a pre-testing including 5 audit partners and 3 audit managers, none of whom took part in the final study. Pretesting was necessary to test the clarity of the instrument, particularly to guarantee that the case setting represents well the real audit context that auditors usually encounter, that the instructions were clear and the variable manipulation and questions are interpreted the way they are intended to be.

In the case settings, participants were invited to assume the role of an audit partner who has received a report from the audit engagement team that shows a potential overstatement of net income. Most importantly, a disagreement emerged between the audit team and the client management; therefore, the audit partner should negotiate with the client in order to resolve this issue.

The overstatement is due to difference in estimates of the allowance for obsolete inventory. Although the company increased the balance in its allowance, the audit team manager still considers that \$4.5 million should be added to the allowance, which is considered as a likely material misstatement (see appendix E). The forthcoming negotiation is fundamentally about the adjustments in the estimates that the client needs to make to the financial statements.

The case also describes the engagement risk context, the nature of the client pressure pursued on the audit firm, a description of the corporate governance mechanisms of the firm and, in line with the auditor-client negotiation research design, a brief introduction to the client company.

Researchers have acknowledged that it is essential to consider what should be measured; a deep knowledge and understanding of the study variables is therefore a

fundamental step before developing the questionnaire. Christophersen and Konradt (2012) further added that designing a measurement model is above all a rigorous theoretical exercise that requires high precision. Therefore, it is indispensable to set up a coherent conceptual definition of all constructs before gathering the data. Moreover, researchers should ensure that the conceptualizations of the constructs are consistent with the way they are operationalised.

6.8.2 Variables measurement

Auditing research has indicated that constructs like RISK, PRESSURE and POWER are complex in nature; therefore, different elements of information should be selected in order to ensure that they are completely captured in the research design. Moreover, as discussed previously, it is expected that auditors have different interpretations for the information set presented to them, Further Beattie et al. (2001) and McCracken et al. (2008) have argued that the replication of the real context of audit setting is not always successful as participants would interpret information differently.

In order to address this limitation, structural equation modeling has been adopted as a research analysis technique. In fact, this technique enables incorporating each participant's estimation of every single piece of information presented in the case scenario. This section explains in detail the different indicators used to represent the latent constructs of the study (see the expansion in Figure 5).

6.8.2.1 RISK

The independent variable engagement risk is denoted as the latent variable RISK. I included the engagement risk manipulation in the first paragraph of the case, specifically through four phrases that highlight the client's engagement risk. These four phrases are profiled in the Table 5, Panel A.

As measured in Brown and Johnstone (2009), engagement risk is manipulated at high and low levels. Specifically, clients with high engagement risk are publicly held (St. Pierre and Anderson, 1984; Bell et al., 2002). They recorded mediocre financial results (Johnstone, 2000) as well as decreasing market share.

Finally, management bonuses were tied to sales target and the client had not met its sales target. In fact, compensation contracts can induce companies in earnings management practices (Dye, 1988; Schipper, 1989) which is related to auditor's loss risk (Carcello and Palmrose, 1994; Dechow et al., 1996).

In the low engagement risk condition, the client company is privately held, they recorded good financial results with an increasing market share and management bonuses were tied to sales, which are met by the client.

Table 5 Independent variables Measurement

Panel A: Manipulation of the Client engagement risk

High engagement risk	Low engagement risk
-Decreasing market share	-Increasing market share
-Bad financial ratios compared to industry	-Good financial ratios compared to industry
-Public firm	-Private firm
-Management bonuses scheme are based on sales which are not met	-Management bonuses scheme are based on sales which are met

Panel B: Manipulation of the client pressure

High client pressure	Low client pressure
-Large client based on the audit fees	-Small client based on the audit fees
-The client is soliciting bids for next year	-The audit firm will remain the auditor for next year.
-making the adjustments will result in missing the analysts' forecasts.	-Making the adjustment will not result in missing analysts' forecasts.

Panel C: Corporate governance mechanisms

Weak corporate governance mechanisms

- The audit committee has tendency to be sympathetic toward the management's position
- The audit committee is composed of three non-executives directors. Only one of the members is a CPA and has five years of experience in public accounting
- The audit committee members ask very few questions and meet two times a year.
- The board has granted the audit committee limited power in executing its authority, and very rarely will the board side with the audit committee on contentious issues involving management.

Strong corporate governance mechanisms

- The audit committee exercises independent judgement without the tendency to be sympathetic toward management.
- The audit committee is composed of three individuals, who are all independent. Two of the members have extensive experience in public accounting and the third member is financially literate
- The audit committee members ask many probing questions and meet frequently
- The board has granted the audit committee a high level of power in executing its authority and always sides with the audit committee on contentious issues involving management.

Table 6, Panel A describes the five indicators used to represent the auditors' perception of engagement risk. Since the engagement risk is "risk the audit firm is exposed to, and it involves the potential loss of, or injury to the professional practice from litigation, adverse publicity, or other events arising in connection with the audited financial statements" Brown and Johnstone (2009:78). We first asked participants about their assessment of reputation, litigation and likelihood that the company had misstated their accounts. Therefore, the three first indicators represent participants' assessment of litigation, reputation loss and misstatements. The fourth indicator represents the overall assessment of the engagement risk; we added the overall assessment indicator to double check that manipulation was successful. Finally, the fifth indicator is related to financial condition assessment since poor financial condition is related to high engagement risk.

We decided to split these indicators into three subsets (i.e. ER1, ER2 and ER3), therefore the first three indicators; i.e. litigation, reputation and misstatement represent the latent construct ER1, the overall engagement risk assessment represents the latent variable ER2 and financial condition represents the latent variable ER3. This split was imposed by the factor loading results, as it will be discussed in the next chapter.

Table 6 Indicators of research constructs

Variables	Item
Panel A: Engagement Risk	
ER1	<p>What is the likelihood that litigation might be brought against your firm as the auditor of company?</p> <p>What is the likelihood that you and your audit firm's reputation will be affected by auditing this company?</p> <p>What is your assessment of the likelihood that the company's management might have misstated their accounts?</p>
ER2	Based on the information presented in this case, how would you assess the engagement risk?
ER3	What is your assessment of the company's financial condition?
Panel B: Client Pressure	
Client pressure	<p>Given your knowledge of the client so far, to what extent do you perceive a threat from the management of non-renewal of the audit engagement?</p> <p>To what extent do you perceive that your fees will be affected by losing this client?</p> <p>To what extent did you perceive that making the adjustment precipitates the client missing of analyst forecast?</p>
Panel c: Bargaining Power	
	<p>How would you characterize corporate governance mechanisms?</p> <p>Do you believe that you will receive support from the company audit committee in conflicting situations?</p>

6.8.2.2 PRESSURE

The independent variable client pressure is denoted as the latent variable PRESSURE. We describe PRESSURE by manipulating three items (see Table 6, Panel B) across cases. These three items have been selected in a way that enables one to replicate the real-world audit setting. Beattie et al. (2001) and McCracken et al. (2008) have provided a thorough fieldwork cases that investigate this construct.

In line with important client pressure characteristics found in prior audit literature (Nelson et al., 2002), the construct of interest-client pressure covered three main dimensions. These dimensions allow me to frame robust manipulation. In fact, what is fundamental to my study is to ensure that participants perceive a pressure from their client to make them accept their alternative². Therefore, in the high client pressure version of the case, the number of billable hours of the client is important, there is a non-renewal threat for the upcoming year and the analyst forecast will be missed if the proposed adjusting entries are made.

In contrast, in the low client pressure case version, the number of billable hours is not important, the audit firm is remaining the auditor for next year and recording the proposed adjusting entries will not result in missing the analyst's forecasts.

Table 6, Panel B describes the three indicators used to represent the three items that characterize the latent variable PRESSURE.

² It is worth noting that participants may perceive this as an indirect threat that is found to be more effective than direct threats in prior literature (Pruitt and Carnevale (1993)).

6.8.2.3 POWER

The independent variable bargaining power is denoted as the latent variable POWER. We focused on the strength of the Audit Committee to describe the auditor bargaining power, as it has been found to improve the auditor's relative bargaining power (Brown-Liburd and Wright, 2011). The audit committee plays an important role in controlling the audit process and arbitrating in the potential disputes that may occur between the auditor and the client management (U.S. House of Representatives 2002). Therefore, a strong audit committee is expected to enhance the relative bargaining power of the auditor vis à vis the client management in negotiation (Ng and Tan, 2003).

According to DeZoort et al. (2003), four elements are fundamental for a strong audit committee, particularly composition (i.e. expertise, independence, integrity and objectivity); authority; resources and diligence. Consistent with these elements, in the strong condition the audit committee is composed of independent knowledgeable members with high experience in public accounting. They ask many probing questions and meet frequently. Further, the board has granted the audit committee sufficient power to achieve its objectives, moreover it supports the audit committee in conflicts that may occur with management.

In contrast, in the weak condition, the audit committee is composed of dependent members, only one member is financially expert and all the rest are financially illiterate. Further the members do not meet frequently and ask few questions. Furthermore, the board has granted the audit committee limited power to exercise its authority and it rarely supports the audit committee in conflicts with management. Our manipulations are in line with institutional theory (Orton and Weick, 1990; Kalbers and Fogarty, 1993; Gendron et al., 2004; Fogarty and Rogers, 2005) in the sense that the audit committee can meet the regulatory requirements but may not fulfil its responsibilities.

Table 6, Panel C describes the two indicators used to represent the two items that characterize the latent variable POWER. The first indicator represents the corporate governance mechanisms assessment, and the second indicator represents the support that auditors expect to receive from the audit committee. Given that the audit committee is defined as a key component of effective corporate governance, we asked participants about corporate governance strength, the second question focuses on the role of the audit committee in supporting the auditor in resolving contentious issues that enhances their bargaining power.

6.8.2.4 Accept

Participants are asked to rate their likelihood of accepting the management's alternative. (See details in Figure 5). This assessment consists in an observed measured variable in our model, which is denoted as "Accept". Prior studies have revealed that this single question is as effective as multiple questions in assessing auditor's acceptance of management alternative (Locke and Latham, 1990; Gibbins et al., 2010).

6.8.2.5 Adjust

Auditor's proposed adjustment, which I denote ADJUST was measured by asking the participants about the amount they require to be adjusted and the amount a typical auditor would insist on (See details in the notes in Figure 5). These questions have been shown to be effective in assessing the adjustment amount in Gibbins et al. (2010)'s work.

6.8.2.6 Negotiations strategies

Auditor's intended negotiation strategies were measured using a shortened version (nine items – three contending, one compromising, three concessionary and two integrative items) of the twenty- five item measure proposed by Gibbins et al. (2010)

who used the highly validated instrument of Rahim (1983) and adapted it to the audit context. It is worth noting that I could not apply Gibbins' instrument due to its length and to the repetitious of its items. Participants were asked to rate their likelihood of using the nine tactics related to negotiation strategies when resolving the disagreement (see Table 7). Finally, they answered demographic questions. Table 7 illustrates the five negotiation strategies and related tactics with wording employed in our study.

Table 7 Wording of negotiation strategies

Response intended use questions (not numbered in the experiment)	Contend	Compromise	Concede	Expand agenda	Problem solving
1. I would bring other issues to the discussion, such that I could trade off on other issues to resolve this issue in my favour				X	
2. I would try to satisfy the expectations of the management			X		
3. I would argue with the management to show them the merits of my position	X				
4. I would try to find some middle ground to resolve this issue with the management		X			
5. I would use my influence to get my position accepted by the management	X				
6. I would use my expertise in accounting to influence the resolution in my favour	X				
7. I would try to work with the management to find new solutions to this issue that satisfy both of our expectations					X
8. I would try to satisfy the needs of the management			X		
9. I would make concessions from my position to the management			X		

Source: Gibbins et al., (2010:585) "The auditor's strategy selection for negotiation with management: Flexibility of initial accounting position and nature of the relationship »

6.8.2.7 Financial information

We selected basic financial information auditors are generally briefed in, in order to make the case real and to be consistent with previous auditor-client negotiation research. In fact, financial statement users generally employ financial ratio to assess the financial performance of the company. These ratios are generally grouped according to the information they produce; e.g. liquidity, profitability or activity level. The current study used these ratios as indicators for financial information.

Liquidity ratios. Liquid asset is the asset that can be easily converted into cash. Firm's liquidity involves the firm's ability to cover its debt (Weston and Brigham, 1993) . In order to assess the liquidity, we examine the relationships between the current asset and the upcoming obligations. Liquidity ratios give information about the continuity of company's business in the short-term run. Generally, financial statement users use three liquidity ratios: current ratio, liquidity ratio and quick ratio. In this thesis, I decided to retain current ratio and quick ratio to represent liquidity.

Current ratio. The current ratio represents the relationship of current assets to current liabilities, it indicates whether a firm is able to pay its current debts; therefore, it is an efficient indicator of the sufficiency of working capital (Price et al. 1993).

Current assets represent all the assets that can be transformed into cash within a year e.g. short-term investments, accounts receivables, inventories and prepayments. Whereas current liabilities represent any financial obligation due within a period of one year e.g. accounts payables, taxes, wages etc. (Moyer et al. 1992).

Current Ratio= Current Assets/Current Liabilities

Quick ratio (Acid test ratio) one of the limitations of using current ratio is that it does not take into account immediate liquidity since it includes inventories which are not as liquid as cash (Price et al., 1993). Therefore, inventories should be removed from current assets when assessing immediate liquidity (Moyer et al., 1992). Hence, to calculate this ratio we deduct inventories from current assets and we divide this amount by current liabilities.

Quick Ratio = (Current Assets- Inventories)/Current Liabilities.

Activity ratios (Asset turnover ratios). The objective of financial management is to ensure that the resources of the firm are allocated efficiently to different asset accounts (Moyer et al. 1992). In this context, activity ratios give information about the revenue generated by a particular asset compared to the amount invested in this asset.

Account receivable turnover. This ratio indicates how a firm extends credit and collect the debts related to credit sales. In other words, it shows whether the company is efficient in allocating its assets. Since accounts receivables represents an interest free loans to customers, firms lose more when the deadlines granted to clients are long. This ratio is calculated by dividing total net assets by the accounts receivables.

Accounts Receivable Turnover =Total Net Sales/Accounts Receivables.

A high account receivable turnover ratio serves as an indicator of the time a firm is collecting its receivables.

Inventory turnover ratio. This ratio shows how long it takes a company to sell its inventories and replace them during the accounting period, this shows whether the company holds unnecessary merchandise in the warehouse. This ratio is calculated by dividing the cost of goods sold by the average inventory.

Inventory Turnover = Costs of Goods Sold/Average Inventory

A high turnover ratio indicates that the company does not take long to sell its goods (Price et al., 1993).

Current assets turnover ratio. This ratio answers the following question: how many times does the company needs to renovate its current assets? This ratio is computed by dividing the net sales to current assets.

Current Assets Turnover Ratio = Net Sales/Current assets

Profitability ratios

The primary objective of a business is to create wealth for their owners, in this context profitability ratios show whether the created revenues exceed the expenses (Foster III and Vickrey, 1978). These ratios indicate the effectiveness of the firm in financing and investment decisions. According to Moyer et al. (1992), profitability ratios are useful to assess the long-term continuity of a business.

Net profit margin ratio. This ratio computes the profitability of the firm's sales excluding all expenses (taxes and interests)

Net Profit Margin Ratio = Earnings after taxes/Sales

Return on equity ratio. This ratio is considered as the most powerful financial ratio, it calculates the amount of the profit generated from every money unit of net assets. It indicates the effectiveness of the company in generating earnings growth.

Return on Equity = Net Profit before Taxes/Shareholder's Equity.

Finally, we included sales, total assets and income for financial statements items like the majority of experiment used in auditor-client negotiation research (Fu et al., 2011; Koch and Salterio, 2017).

6.8.3 Reflective and Formative Constructs

Latent constructs can be measured either reflectively or formatively depending on the causal relationships between indicators and their relevant constructs (Bollen and Lennox, 1991). If the construct causes the indicators, then the measurement model is reflective. On the other hand, if it is the indicator that causes the construct then the measurement model is formative (Hair Jr et al., 2014). It is worth noting that in this case there is no covariance between indicators (Mackenzie, 2005).

6.8.3.1 Common Latent Construct Model with Reflective Indicators

Common latent construct assumes that the construct variation determines the covariance between the measures (Mackenzie, 2005). For this reason, indicators are denoted effect indicators as they reflect the construct of interest (MacCallum and Browne, 1993; Finn and Wang, 2014). The arrows from the construct to the related indicators depict the effect relationship. This measurement model is mostly used in behavioural and organisational literature (Mackenzie, 2005). Since the indicators reflect the construct, the correlation between indicators should be high which would indicate high level of internal consistency (Bollen and Lennox, 1991; MacCallum and Browne, 1993). Bollen and Lennox (1991), have added that the expected effects of unidimensional indicators are “interchangeable”. In fact, all measures are extracted from one field which incorporates all its characteristics. Therefore, removing some of the indicators should not affect the meaning of the construct.

6.8.3.2 Composite Latent Construct Model with Formative Indicators

In the composite latent construct model, it is the indicators that cause the construct, it is not necessary for the indicators to correlate with each other (Henseler et al., 2009; Hair Jr et al., 2014). It is worth noting, that the content validity of the construct is expected to decrease if one or some of the indicators are removed (Mackenzie, 2005; Christophersen and Konradt, 2012). Moreover, high multicollinearity between formative indicators could result in parameters estimation bias (Westlund et al., 2001).

Researchers should consider carefully whether the constructs are formative or reflective since an inappropriate measurement model can result in content validity issues. Moreover the relationships within the structure model may be affected consequently the validity of the resulting theories (Hair Jr et al., 2014).

In the current study, we used both reflective and formative measurement models. All the financial information constructs have been measured as formative whereas engagement risk (ER1, ER2 and ER3), client pressure, bargaining power, negotiation strategies, and “adjust” have been measured with reflective measurement constructs.

The Structural Equation Modelling (SEM) technique is considered as an established technique in behavioural research since it enables the assessment of the measurement model and the structural model in a simple way. This technique can be either covariance based or component based; e.g. PLS (Petter et al., 2007). We adopted PLS technique as it enables to measure formative measure model.

6.9 Summary

This chapter covered the research methodology in detail. It first exposed all the possible research methodologies that can be adopted in business studies and then explained the

choice of the methodology selected. This research is based on a positivist paradigm with a deductive approach and using an experiment.

This chapter ends with presenting in detail the research design used in the current study, starting with a description of the case setting, the description of the study's variables and their measurement. I adopted The Throughput model framework, which, entails that judgement (i.e. the acceptance of management alternative and the amount required to be adjusted) represent the independent variables for negotiation strategies decision choice in the second stage. This chapter also discussed the sample used to test research hypotheses, this sample consisted of a mix of professionals having work experience in audit attending an audit course in an accredited American university. These are used as surrogates for audit partners given the difficulty of access to these professionals.

Chapter 7: Data analysis and findings

7.1 Introduction

The objective of this Chapter is to present the analysis and findings of the quantitative data and to test the developed research hypotheses. As mentioned in the previous Chapter, data were obtained using an experiment in order to investigate negotiation strategies choice given a specific context. In order to analyse the obtained data and the developed model, the Statistical Package for Social Sciences (SPSS) version 23.0 and SEM using Smart-PLS version-3 have been used.

SEM represents the second-generation multivariate data analysis method. This technique is applied to confirm existing theories (CB-SEM) or to build new theories (PLS-SEM). One of the advantages of PLS-SEM is to succeed in its objective of predicting the dependent variables without demanding rigorous requirements concerning the data, which appears to be especially relevant in social sciences. Furthermore PLS-SEM can handle complex models as compared to CB-SEM. It also takes into account formative measurements and treats small sample size.

A PLS path model has two main components. The first model is called inner model or structural model which is concerned with the relationships between the constructs. It specifies how the constructs are associated to each other. The second model, which is called the outer model or measurement model, is concerned with relationships between the constructs and their respective indicators. It indicates how the constructs are measured.

Specifically, and following the PLS analysis steps, this analysis consists of two parts: the first part involved the measurement model, also denoted as the outer model, which

is concerned with the latent constructs and their respective indicators. The second part involves the structural model called inner model which investigate the relationships between the exogenous and endogenous variable (Wong, 2013; Hair Jr et al., 2014).

In fact, this technique is preferred over standard regression as it ensures that respective indicators capture their related theoretical constructs of the study in order to ensure the validity and reliability of the derived results. According to Smith and Langfield-Smith (2004) and Hair Jr et al. (2014), researchers should take into consideration the measurement error that usually occurs with theoretical constructs as this may result in a biased estimation of the regression coefficient of the developed model.

In what follows, we provide a detailed discussion of the procedures of the measurement and structural model assessment.

7.2 Assessment of Measurement Model

It is essential for researchers to distinguish between reflective and formative constructs when they assess the outer model (Roy and Tarafdar, 2012; Finn and Wang, 2014). In this light, the procedures involved with the reflective measurement model differ from the formative constructs since they hold different assumptions of the conceptualisation and operationalisation of the latent constructs (Hair Jr et al., 2014).

7.2.1 Assessment of the Reflective Measurement Model

Overall, reflective constructs assess the constructs through the internal consistency and validity of the constructs. The following section will discuss in detail the process of assessing the reliability and convergent validity of the theoretical constructs.

7.2.1.1 Indicator Reliability

The reliability of indicators is assessed through their loadings with their relevant constructs (Hulland, 1999), specifically through the standardized indicator loadings (Hair et al., 2011) which consists of the correlation of an indicator with the summated score, also this measure considers the correlation among indicators.

Although exploratory studies accept loadings of 0.5 (Hair et al., 2011), most researchers use 0.7 threshold when assessing indicator's reliability (Hulland, 1999). Loadings indicate that the percentage of the explained variance in the indicator is derived by the construct (Hulland, 1999).

In this study individual item reliability has been assessed by loadings into the combined loadings which indicate whether the indicators load on their associated latent variables.

PLS results indicate that seventeen items had the required internal consistency; however, reliability of four items was below the threshold. Consequently they were removed from the dataset as their deletion resulted in improvement in the average variance extracted (AVE) and composite reliability measures (Hair Jr et al., 2016).

Tables 8 to 15 present the seventeen items that loaded into their respective latent constructs. This results in the study theoretical construct represented by the following indicators:

Table 8 Indicator Loadings for Risk measures

Indicators	ER1	ER2	ER3
Litigation	0.841		
Misstatement	0.811		
Reputation	0.881		
ER		1.000	
FC			1.000

Table 9 Indicator Loadings for PRESSURE Measure

Indicator	Outer loading
Non-renewal Threat	1

Table 10 Indicator Loadings for PRESSURE measure

Indicator	Outer loading
Gvce Mechanisms	1

Table 11 Indicator Loadings for ADJUST measure

Indicators	Outer loadings
Adjust	0.859
Typical adjust	0.735

Table 12 Indicator Loadings for Concede Measure

Indicators	Outer loadings
Concede 1	0.871
Concede 2	0.947

Table 13 Indicator Loadings for Contend measure

Indicators	Outer loadings
Contend 1	0.740
Contend 2	0.780
Contend 3	0.742

Table 14 Indicator Loadings for Compromise measure

Indicator	Outer loading
Compromise 1	1

Table 15 Indicator Loadings for Integrative measure

Indicator	Outer loading
Integrative 2	1

The inspection of the earliest results of the smartPLS report show that outer loadings are below the threshold (less than 0.7) for client pressure related items (i.e. analyst forecast and fees) as a result non-renewal threat and analyst forecast were removed and the analysis was performed using the single item construct non-renewal threat.

Likewise, SmartPLS results indicate low outer loadings values for bargaining power items (i.e. AC support) was removed from the data set and bargaining power latent variables was presented by the single item construct Governance mechanisms.

With the regard to latent variable "ADJUST", the respective items have outer loadings above 0.7.

Similarly, with “contend” the selected items for this variable have achieved the outer loadings threshold. However, for the latent variable “concede 1” item has outer loadings less than 0.7 (i.e. concede 3), therefore this item was removed from the dataset since its deletion improves AVE and composite reliability.

For “integrative”, earliest PLS results indicated low outer loadings (less than 0.7) for “integrative 1”, hence this item was removed and “integrative” was measured through “integrative 2”.

Initial results of smart PLS results show that engagement risk constructs should be grouped into three subsets, precisely Litigation, reputation and misstatement loaded highly together in one construct which we denoted ER1. While ER assessment represented a new latent construct, denoted ER2 and recode FC represented another latent construct ER3.

After removing all the indicators that did not highly load into their respective constructs, our measurements satisfied the criteria of item reliability as shown in Tables 8 to 15.

7.2.1.2 Assessing Construct Reliability

Reliability consists in measuring the consistency of the latent construct across the items (Hair Jr et al., 2014). Further, it refers to “the degree to which the measures provide consistent results if used in different studies or context... the degree to which a scale is free from measurement error” (Cooper and Schindler, 1998: 171).

Researchers often used internal consistency in order to measure reliability (Hair Jr et al., 2014). This can be performed using different measures such as Cronbach’s alpha and composite reliability.

Cronbach's alpha

Cronbach's alpha is widely used in social sciences research to assess internal consistency between indicators (Hair Jr et al., 2014). The threshold for this measure is 0.7; however this could be reduced to 0.6, particularly in exploratory research (Hair Jr et al., 2014). Further, Nunnally (1978) argued that Cronbach's alpha of 0.5 can also be acceptable. Cronbach's alpha has shown its limitation with regard to its sensitivity to the number of items employed in measuring a construct. In fact, the more indicators that are used for construct measurement, the more the value of Cronbach's alpha coefficient will be important even though the degree of correlation is the same (Hair Jr et al., 2014). Moreover, Cronbach's alpha supposes that all indicators have the same reliability (Hair Jr et al., 2014). Given these limitations, Hair et al. (2011) do not recommend using Cronbach's alpha and suggest using the composite reliability measure instead.

Composite Reliability

Fornell and Larcker (1981) developed another measure of internal consistency that does not assume equal reliability of different indicators. In this measure, indicators are prioritized according to their reliability during the estimation process. For this reason, Hair et al. (2011) recommend using this indicator instead of Cronbach's alpha, coefficient that ranges between 0.6 and 0.7 might be satisfactory for exploratory research however in more advanced research this coefficient should be higher than 0.7 (Hair et al., 2011).

It can be seen from Table 16 that the composite reliability of all constructs of the study is above 0.7. In fact, all the variables have CR above 0.778, which indicates that no construct of the study lacks internal consistency. Cronbach's alpha coefficient are all above 0.6 except for ADJUST which is 0.44. We followed Hair et al. (2011)

recommendations and measured internal consistency through composite reliability. Therefore, we conclude that the constructs are internally consistent.

Table 16 Cronbach's alpha and composite reliability of constructs

Construct	Cronbach's Alpha	Composite Reliability
ER1	0.802	0.882
ER2	1.000	1.000
ER3	1.000	1.000
PRESSURE	1.000	1.000
POWER	1.000	1.000
Accept	1.000	1.000
ADJUST	0.441	0.778
Concede	0.801	0.906
Contend	0.622	0.798
Compromise	1.000	1.000
Integrative	1.000	1.000

7.2.1.3 Assessing Construct Validity

Construct validity refers to the effectiveness with which the theoretical construct is represented to its related indicators (Hair Jr et al., 2014), therefore the success of the operationalization of the constructs in the study. Construct validity can be assessed by various measures such as convergent validity and nomological validity (F. Hair Jr et al., 2014). While convergent validity checks whether each measure of a particular construct is correlated with the rest of the measures representing this construct, discriminant validity identifies whether the indicators used to measure a construct are different from indicators that represent other constructs (Hair Jr et al., 2014).

Convergent Validity

Evaluating convergent validity is a fundamental step especially when several items are used to represent the theoretical constructs. The objective of construct validity is therefore to confirm that all the selected items used to measure a particular construct converge with each other. Hulland (1999) highlighted that it is imperative that researchers should not focus on individual indicator reliability and should rather check

whether convergent validity for all measures is established. Average variance extracted (AVE) is employed to measure convergent validity, According to Hair et al. (2011). The value of AVE should be 0.5 or higher in order to establish convergent validity between indicators. In fact, 0.5 AVE value can be interpreted as more than fifty percent of the indicators variance is due to the construct.

Table 4.6 clearly demonstrates that for each latent variable of the study, the AVE is higher than 0.50. This indicates that all constructs of this study are consistent with the rule of convergent validity (Hair Jr et al., 2014).

Table 17 Average Variance extracted

Construct	Average Variance Extracted (AVE)
ER1	0.714
ER2	1.000
ER3	1.000
PRESSURE	1.000
POWER	1.000
Accept	1.000
ADJUST	0.639
Concede	0.828
Contend	0.569
Compromise	1.000
Integrative	1.000

Discriminant validity

Discriminant validity is concerned with the extent to which a construct is different from others (Bagozzi, 1994). Researchers can employ two different measures of discriminant validity using the Fornell-Larcker's criterion, initiated by Fornell and Larcker (1981) and cross loadings criteria initiated by Chin (1998).

Fornell-Larcker's Criterion

Fornell-Larcker criterion requires the AVE for each latent variable exceeds the squared inter-correlation between this latent variable and any other latent variable (Fornell and Larcker, 1981). The square root AVE for each latent variable is compared with the inter-correlation with the other constructs. The SmartPLS's report generates a correlation matrix as shown by Table 19 where the square root average variances extracted (AVE) reported on the diagonal, and the correlation between the latent variable in the off diagonal.

Exploring the results reported in the Table 19 indicated that the square root of all the constructs are higher than the correlation between this construct and other constructs in the same row and column. Therefore, all the constructs have a satisfactory level of discriminant validity.

Table 19 Cross Loadings

	Accept	Adjust	POWER	PRESSURE	Compromise	Contend	ER1	ER2	ER3	Integrative	concede
Accept	1,000	-0,006	0,135	-0,137	0,224	-0,303	-0,067	0,033	-0,211	0,160	0,293
Adjust	-0,030	0,859	-0,186	0,271	0,101	0,115	0,039	0,242	0,116	0,033	0,067
Litigation	0,012	-0,045	-0,247	0,169	-0,031	0,025	0,841	0,420	0,102	0,095	-0,029
Misstatement	-0,104	-0,036	-0,286	0,171	-0,015	0,017	0,811	0,328	0,220	0,017	-0,073
Non- renewal threat	-0,137	0,196	-0,224	1,000	0,253	0,046	0,219	0,276	0,275	0,077	-0,028
ER	0,033	0,228	-0,352	0,276	0,075	0,048	0,463	1,000	0,346	0,092	0,092
Reputation	-0,056	-0,060	-0,197	0,213	-0,061	0,144	0,881	0,436	0,141	0,105	-0,018
Typical Auditor adjust	0,030	0,735	-0,030	0,007	-0,049	0,063	-0,156	0,106	-0,035	0,065	0,198
compromise	0,224	0,046	-0,076	0,253	1,000	-0,111	-0,042	0,075	0,074	0,373	0,344
concedef	0,206	0,063	-0,030	-0,124	0,304	-0,178	-0,158	0,012	0,021	0,282	0,871
concede2	0,310	0,191	-0,167	0,039	0,324	-0,059	0,028	0,132	-0,003	0,423	0,947
contend1	-0,268	0,017	-0,066	-0,018	-0,117	0,740	0,070	-0,020	0,121	0,040	-0,094
contend2	-0,204	0,141	-0,113	0,072	-0,009	0,780	0,060	0,109	0,076	0,013	-0,107
contend3	-0,209	0,110	-0,067	0,056	-0,123	0,742	0,041	0,024	0,019	0,194	-0,058
integrative2	0,160	0,058	-0,136	0,077	0,373	0,104	0,081	0,092	0,153	1,000	0,400
FC	-0,211	0,063	-0,315	0,275	0,074	0,099	0,191	0,346	1,000	0,153	0,007
GVCE	0,135	-0,147	1,000	-0,224	-0,076	-0,109	-0,289	-0,352	-0,315	-0,136	-0,123

Cross Loadings

Chin (1998) has developed another criterion for discriminant validity which compares the cross loadings of indicators with the construct of interest to their loadings with other constructs. The Smart PLS report generates a correlation matrix between the latent construct and their respective indicators as appears in Table 19. The results reported in Table 19 indicates all items have higher loadings with their respective constructs compared to their loadings with other constructs in the same row or column therefore discriminant validity between constructs is established.

7.3 Assessment of the Formative Measurement Model

The objective of this Section is to assess the formative measurement model; this requires using different tests (Bollen and Lennox, 1991; Finn and Wang, 2014; Hair Jr et al., 2014). In fact, indicators in formative models are not expected to correlate, therefore reliability tests are not appropriate for this type of measurement model (Bollen and Lennox, 1991; Henseler et al., 2009). Henseler et al. (2009) added that indicators in this measurement model are error free, which makes reliability perspective inappropriate. Moreover, researchers should not attempt to improve formative indicators by considering the correlations between the indicators as this could affect a construct's validity (Hair Jr et al., 2014). Especially assessing discriminant validity relying on the same criterion used when assessing reflective models is not effective with formative indicators (Chin, 1998).

PLS-SEM essentially assumes that formative indicators should capture all the features of the latent construct of interest (Petter et al., 2007). According to Henseler et al.

(2009), other measures are preferred to assess formative measurement models. In what follows the procedures for formative model assessment will be introduced.

7.3.1 Convergent Validity

The validity of formative measurement constructs can be assessed using two major methods (Henseler et al., 2009). Mainly theoretical justification of the use of the indicators can provide a support for the validity of the constructs, in this light, the theoretical validation of the formative constructs used in the current study has been fully addressed during the variables measurements variables discussion in 10.3. Moreover, these variables have been addressed based on similar published empirical studies, hence this provides a solid ground for the formative measurement model choice.

Alternatively, the validity of constructs can be assessed through statistical analyses of both latent constructs and their respective indicators. Researchers should therefore consider whether the indicators represent the latent variables, in other words, researchers should find a strong and significant relationship between formative constructs and other constructs.

On the other hand, at the indicator level each formative indicator must have an effect on the respective construct. According to Hair Jr et al. (2014:121), "convergent validity is the extent to which a measure correlates positively with other measures (indicators) of the same construct". Therefore in order to assess discriminant validity researchers should develop a reflective measure for the construct under consideration and check whether this reflective construct under consideration is highly correlated with the formative construct, this procedure is called redundancy analysis (Chin, 1998).

When assessing formative measurement models, researchers should be concerned about collinearity issues between indicators. In fact, as opposed to reflective indicators, which

are interchangeable by definition, formative indicators are not supposed to correlate with each other. On the contrary, this multicollinearity can cause problems from a methodological and interpretational viewpoint.

Collinearity means that two or several formative items provide identical information. This may be due to the fact that one indicator is entered twice or because this indicator is a linear combination of another indicator.

High collinearity within formative measurement model is problematic as this can lead to a biased estimation of the coefficients and their associated statistical significance. Specifically, collinearity increases standard errors, which makes it difficult to prove the significance of the estimated coefficients. This is even more problematic when the sample size is small, where the standards errors are usually important and induced by the sampling error. Moreover, the value and sign of the coefficients might be biased.

7.3.2 Assessing collinearity

To evaluate collinearity between indicators, tolerance must be computed. It indicates the variance explained exclusively by a particular formative indicator and not by other indicators.

A reciprocal indicator of collinearity is the variance inflation factor (VIF) which is calculated as $VIF_x = 1 / Tol_x$, SmartPLS and provides the values of VIF to assess multicollinearity. Hair Jr et al. (2016) suggest that VIF should be lower than 5 and accordingly tolerance lower than 0.2. By keeping these values at these levels, researchers ensure that other formative indicators explain 80% of the variance of the indicator. Table 20 below indicates that all formative constructs do not suffer from multicollinearity issues.

Table 20 Collinearity

Indicators	VIF
Current ratio	3.876
Income	4.738
Quick Ratio	3.876
ROE	1.000
Sales	5.499
Total assets	1.390
Inventory	1.000

7.3.3 Assessing the Significance and Relevance of Formative Indicators

In order to assess the relevance of using a specific formative indicator, researchers should examine its outer-weights. Outer-weights are derived from multiple regressions with latent theoretical constructs scores as explained variables and formative items as explanatory variables (Hair Jr et al., 2016). Since it is assumed that the formative indicators compose the construct, it is expected that the value of R square generated by multiple regression analysis is equal one, in other words the selected indicators completely explain the construct. Similar, to regression analysis the values of outer-weights of different items might be compared with each other to identify the contribution of each item with the theoretical construct. The objective is therefore to check if the formative item causes the latent construct. This could be achieved by examining the significance of the outer-weights using the bootstrapping procedure. It is worth noting that a non-significant item does not indicate poor measurement model quality. In fact, researchers should also be concerned about absolute contribution to the construct, which is indicated by outer-loadings of the formative item, which corresponds to the bivariate correlation between the item and its respective construct. If the outer-weight is not significant but corresponding outer-loading is high (more than 0.5), then the indicator should be considered as absolutely important but not relatively

important. In this case, the indicator should be retained. However, when the outer-loadings of non-significant outer-weights is below 0.5, then the decision of deleting the indicator is left to the theoretical conceptualisation of the construct (Cenfetelli and Bassellier, 2009).

Overall, the assessment of formative measurement models consists of establishing convergent validity, assessing indicators' collinearity and analysing indicators' relative and absolute contribution and their significance.

Table 21 provides the results of the formative constructs i.e. profitability, liquidity, activity level and financial statements items; it shows indicators' outer-weights, the t-values and the associated significance levels. The results show that all formative indicators are significant with the exception of income and total assets. Further, I used alternative sign change option for running the bootstrapping procedure. (i.e. individual sign change or construct level changes), only income remains insignificant we therefore examine the outer-loadings and their respective t-values. The t-value of the income item is 0.818 and the t-value is above 2.57 which means its significance ($p < 0.01$). Moreover, previous auditing negotiation research provides support for the relevance of this indicator for capturing financial statements items; consequently, income is retained in the construct although its outer-weight is not significant. The evaluation of the reflective and formative measurement model proved the required validity and reliability and achieved all the necessary tests to proceed with assessment of the structural model and the hypotheses testing process.

Table 21 Formative constructs significance

Formative constructs	Formative indicators	Outer weights (Outer loadings)	Sample Mean (M)	Standard Deviation (STDEV)	T (O /STDEV)	Statistics	P Values	significance level
Liquidity	Current Ratio	0,385 (0,944)	0,348	0,232	1,662	0,097	*	
	Quick Ratio	0,648 (0,981)	0,677	0,223	2,915	0,004	**	
Profitability	ROE	1 (1)	1	0			single item construct	
	Income	-0,233	-0,237	0,232	1,004	0,316	NS	
FS	Sales	1,163 (0,991)	1,165	0,218	5,349	0	***	
	Total assets	0,067	0,047	0,135	0,498	0,619	NS	
Activity level	inventory	1 (1)	1	0			single item construct	

Note: NS = not significant
 *p < 0.10.
 **p < 0.05.
 ***p < 0.01.

7.4 Assessment of Structural Model

Once reliability and validity of the latent constructs of the study have been validated, it is possible now to assess the structural model and test the developed hypotheses. Therefore, the objective of this chapter is to examine the structural relationships between the latent variables and to validate the developed conceptual framework.

This Chapter starts with the examination of the data with inspecting the missing values and the outliers. Descriptive statistics and normality of the research constructs will be presented in a second section. The third section will focus in the structural model assessment and hypothesis testing based on PLS-SEM procedures (i.e. path coefficients, coefficients of determination (R^2) and predictive relevance).

The results of the hypotheses testing will be presented in the fourth section based on the paths coefficients and the significance levels. Finally, the last section will conclude with a summary of the Chapter.

7.4.1 Data Examination

According to Hair Jr et al. (2014), data examination is a fundamental step before analysing the data that allows researchers to be familiar with the data they need to analyse. In this context, data examination consists mainly of the identification of the missing values and outliers and deciding how to deal with these values, it also consists in testing the normality of the constructs. This section presents a detailed description of the procedures used for the diagnostic of data (i.e. missing values, outliers and normality assumption testing).

7.3.1.1 Analysis of Missing Data

When the participants have not answered one question or more of the survey, valid values for some variables will be lost. It is therefore, fundamental to investigate the pattern and the importance of the missing values and to explore the reasons why the respondents failed to answer the questions related to these values (Hair Jr et al., 2014).

Mainly two types of missing data can occur: missing data that is inevitably imposed by the research design and the technique used and missing data that is non-ignorable and caused by factors related to the procedure of collecting data. While there is no remedy for the inevitable data, the second type of missing data needs specific attention from researchers. In this context, in order to distinguish between ignorable from non-ignorable missing data, researchers need to examine the extent and the pattern of the missing values (Hair Jr et al., 2014). The general rule is to ignore missing data when they are under 10% and 15% to prevent bias in estimation (Hair Jr et al., 2014). It is worth considering the reduction in the sample size and the variables that represent the theoretical constructs when deleting missing values (Hair Jr et al., 2014).

Inspection of the extent of missing data in the current research by SPSS shows that the percentage of missing data is less than 10% for all the study's variables. Furthermore, this study investigated whether the missing data is completely at random (MCAR), to check the existence of systematic error (Hair Jr et al., 2014). In this context, Little's MCAR test has been conducted through SPSS to examine the patterns of missing data of the variables study (results reported in the Appendix B).

This test set the following null hypothesis: The data are missing completely at random (MCAR).

Chi-square 22.344, df.415, sig. 1.00, $p > 0.05$ supports the null hypothesis thereby the randomness of data; this confirms that data is free from systematic errors. The current study applies mean replacement for missing data which is considered as an effective method when the level of missing value is low (Tabachnick and Fidell, 2007; Hair Jr et al., 2014).

7.3.1.2 Detecting Outliers

Outliers are observations that are significantly different than the rest of the observations (Hair Jr et al., 2014). Although these values can detect particular features of observations that give insights for the research, it is quite likely that they bias research findings (Hair Jr et al., 2014). In order to check for the outliers and boxplots have been performed. As indicated by the boxplots in Appendix A only few cases were identified as multivariate outliers which is tolerable and inevitable (Tabachnick and Fidell, 2007). Further Hair Jr et al. (2014) recommend the deletion of outliers only if they are not illustrative of the population and depart from normality. More importantly, the PLS-SEM technique does not require the data to be normal; therefore, this study retained the outliers.

7.3.1.3 Assessing Data Normality

Multivariate analysis requires data to be normal to ensure validity of the derived statistical results (Hair Jr et al., 2014). Normality distribution of data has been tested by examining skewness and kurtosis, which compare the distribution of data to the normal distribution (Hair Jr et al., 2014).

Kurtosis compares the peakedness or the flatness of the data distribution to that of the normal distribution (Hair Jr et al., 2014). The kurtosis of the normal distribution is zero, and values below zero indicate a flatter distribution, while values above zero indicate a

peaked distribution (Hair Jr et al., 2014). Similarly, the value of skewness of a normal distribution is equal to zero which indicates a balanced and systematic distribution. In this light, a distribution is positively skewed if it is shifted to the left and negatively skewed if it is shifted to the right (Hair Jr et al., 2014).

Testing the skewness and kurtosis of data distribution, can be performed using the Z distribution (Hair Jr et al., 2014). The current study applied the widely used critical value of ± 2.58 at the 0.01 significance level (Hair Jr et al., 2014). These statistical tests will be presented besides the descriptive statistics in the following section.

7.3.1.4 Common Method Bias

There has been a consensus among behaviourist researchers that the common method bias represents an issue for the validity of the results. This bias corresponds to the threat that the actual variance is due to the methods of measuring the constructs and not to the constructs of the research (Lindell and Brandt, 2000; Bagozzi and Yi, 1990).

In order to make sure that my data does not suffer from method biases, I performed Harman's single factor test (Podsakoff et al., 2003), which calculates the variance explained by a single factor. According to this test, the cumulated variance should not exceed 50%. Table 23 below indicates that the variance explained by a single factor is 31.428; therefore we conclude that our data is free from common method biases.

Table 22 Harman's single factor test

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	7,229	31,428	31,428	7,229	31,428	31,428
2	2,594	11,279	42,708			
3	2,227	9,682	52,390			
4	1,690	7,348	59,738			
5	1,309	5,691	65,429			
6	1,135	4,935	70,364			
7	1,059	4,604	74,968			
8	,811	3,526	78,495			
9	,725	3,150	81,645			
10	,632	2,749	84,394			
11	,609	2,649	87,043			
12	,566	2,461	89,504			
13	,517	2,248	91,752			
14	,462	2,009	93,761			
15	,445	1,935	95,695			
16	,356	1,548	97,243			
17	,239	1,038	98,282			
18	,221	,960	99,242			
19	,160	,697	99,938			
20	,013	,055	99,994			
21	,001	,006	100,000			
22	9,513E-011	4,136E-010	100,000			
23	-1,559E-015	-6,777E-015	100,000			

Extraction Method: Principal Component Analysis.

7.4.2 Descriptive Statistics

7.4.2.1 Sample characteristics

As can be seen in table 23 below, participants who took part in this study have an average auditing experience of 2.75 years (std dev. 0.48), further they experienced on average 7.93 auditor client interactions (std dev. 22.30) per year. 41.9 percent of our participants were female and only 10.4 percent of our respondents were from a big 4 firm.

Table 23 Demographic description of participants

Variable	Mean	Standard deviation
Audit experience	2.75	5.60
Accounting experience	4.02	5.37
Auditor-client interactions per year	7.93	22.30
Accounting courses taken	10.92	11.09
Certificate Accounting training courses	12.18	28.06

7.4.2.2 Engagement risk

According to the measurement model, three main dimensions have been suggested to capture the main aspects of the company's engagement risk. These dimensions include ER1 (i.e. reputation, litigation and misstatement), ER2 (i.e. engagement risk assessment) and ER3 (i.e. financial condition assessment).

The descriptive statistics of these variables, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 24.

Table 24 Descriptive statistics of Engagement Risk variables

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Litigation	-4.0	5.0	0.938	2.814	-0.345	-1.336	146
Reputation	-5.0	5.0	0.842	2.776	-0.327	-1.125	146
Misstatement	-4.0	5.0	2.503	2.105	-1.397	1.519	145
ER	-5.00	5.00	2.143	2.480	-1.402	0.819	146
FC	-5.00	5.00	0.212	3.033	-0.129	-1.433	146

The descriptive statistics indicate an average score of litigation of 0.983, indicating that litigation perception is just above the average in our sample. Similarly, the score of reputation was above the average (0.842). Interestingly, the participants perceived Misstatement, the third engagement risk indicator, as relatively high (2.503) by participants.

The results also indicate a high score (2.1438) of the overall perception of the engagement risk, the company's financial condition perception was (0.212).

These results imply that participant's engagement risk is above the average, however these results should be interpreted with caution as the research design is meant to differ across cases. Therefore, these results are slightly meaningful.

To assess the normality of the engagement risk constructs, the skewness and kurtosis statistics of engagement risk indicators were examined. The skewness and kurtosis statistics of all the indicators fall within the acceptable range ± 2.58 recommended by Hair Jr et al. (2014). These results suggest that data related to engagement risk variables are normally distributed.

7.4.2.3 Client pressure

Client pressure is measured by non-renewal threat; details of the variables used in measuring these constructs have been discussed in the previous Chapter. The descriptive statistics of the variables used in measuring these constructs, including minimum and maximum value; mean; standard deviation; skewness and kurtosis are presented in Table 25.

Table 25 Descriptive statistics of Client pressure variables

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Non-renewal threat	-5.00	5.00	0.919	2.666	-0.390	-1.077	148

The descriptive statistics of the non-renewal threat that are measured on a ten point Likert scale indicate the above average score (0.919). These results suggest that participants on average do not perceive that their fees will be affected by losing this client.

Further for normality testing of the client pressure, skewness and kurtosis statistics, in general fall within the acceptable range ± 2.58 (Hair Jr et al., 2014). These results suggest that data related to the client pressure in general are normally distributed.

7.4.2.4 Bargaining power

Bargaining power has been measured with corporate governance mechanisms perception. The descriptive statistics of corporate governance mechanisms, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 26.

Table 26 Descriptive statistics of Bargaining power variables

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Gvce mechanisms	-5.00	5.00	-1.020	0.258	0.413	-1.302	147

The results indicate that the average score of governance mechanisms is above the average (1.024) which means that on average participants perceive corporate governance as important to some extent. Skewness and kurtosis statistics fall within the acceptable range ± 2.58 suggested by Hair Jr et al. (2014). These results suggest that the data related to bargaining power is normally distributed.

7.4.2.5 Accept

The descriptive statistics of the indicator 'accept', indicate a relatively high value of accept (2.199), which indicates that managers do not seem to accept management's alternative. Skewness and kurtosis statistics fall within the acceptable range ± 2.58 (Hair Jr et al., 2014). These results suggest that the data related to the variable accept are normally distributed.

Table 27 Descriptive statistics of Accept

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Accept	0.00	10.00	2.199	2.043	1.237	1.452	146

7.4.2.6 Adjust

The descriptive statistics indicate a high adjustment amount required by participants for Adjust (3.980) and typical adjust (3.207).

Skewness and kurtosis statistics for 'Typical adjust' fall within the acceptable range ± 2.58 (Hair Jr et al., 2014). These results suggest that the data related to this variable are normally distributed. However the variable 'Adjust', the statistics indicate that it is highly peaked, I decided to keep this variable for the analysis since the PLS does not require the data to be normally distributed.

Table 28 Descriptive statistics of ADJUST

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Adjust	0.00	4.5	3.980	1.030	-2.526	6.109	147
Typical adjust	0.00	4.5	3.207	1.394	-1.126	0.247	147

7.4.2.7 Concede

According to the measurement model and as explained in the Chapter 6, two indicators have been retained to measure the "concede" latent construct (i.e. concede 1, and concede 2). The descriptive statistics of the indicators used in measuring concede, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 29.

The descriptive statistics indicate scores above the average for concede 1 (2.31) and concede 2 (2.715). These results suggest that auditors tend to concede to some extent. In addition, skewness and kurtosis values are within the acceptable range ± 2.58 for all variables (Hair Jr et al., 2014). These results suggest that data related to concede variables are normally distributed.

Table 29 Descriptive statistics of Concede

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Concede 1	0.00	7.00	2.310	1.977	0.500	-0.699	145
Concede 2	0.00	7.00	2.715	2.054	0.489	-0.618	144

7.4.2.8 Contend

Contend was measured using three different indicators. These measures include contend 1, contend 2 and contend 3. The descriptive statistics of the indicators used in measuring contend strategies, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 30.

Table 30 Descriptive statistics of Contend

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Contend 1	0.00	7.00	4.701	2.281	-0.761	-0.641	144
Contend 2	0.00	7.00	4.118	2.120	-0.331	-0.918	144
Contend 3	0.00	7.00	5.731	1.646	-1.471	2.106	145

The descriptive statistics of contend indicate high-level score of contend indicators, that is contend 1 (4.701), contend 2 (4.118) and contend 3 (5.731). These results suggest that participants tend to use more contending strategies.

The skewness and kurtosis values of perceived performance are within the acceptable range ± 2.58 (Hair Jr et al., 2014). These results suggest that data related to contend is normally distributed.

7.4.2.9 Compromise

The descriptive statistics of the indicator used in measuring contend, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 31.

The descriptive statistics indicate a high score of compromise (4.421). These results suggest that auditors use compromising strategies when they negotiate with their client. In addition, skewness and kurtosis values are within the acceptable range ± 2.58 for all variables (Hair Jr et al., 2014). These results suggest that data related to “concede” variables are normally distributed.

Table 31 Descriptive statistics of Compromise

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Compromise 1	0.00	7.00	4.421	1.839	-0.435	-0.399	145

7.4.2.10 Integrative

According to the measurement model and as explained in Chapter 10, “integrative 2” has been retained to measure the integrative component. The descriptive statistics of the variables used in measuring “integrative”, including minimum and maximum values, mean, standard deviation, skewness and kurtosis are presented in Table 32.

Table 32 Descriptive statistics of Integrative

Variable	Minimum	Maximum	Mean	SD	Skewness	Kurtosis	N
Integrative 2	0.00	7.00	5.448	1.615	-1.038	-0.690	145

In general, the descriptive statistics indicate high average scores of integrative 2 (5.448). These results suggest that auditors tend to use integrative strategies to a high extent. In addition, skewness and kurtosis values are within the acceptable range ± 2.58 for all variables (Hair Jr et al., 2014). These results suggest that data related to “concede” variables are normally distributed.

7.4.3 Structural Model Assessment

According to Chin (1998), conventional parametric tests for tests of significance are not suitable for PLS-SEM analysis, which supposes a distribution free variance; non-parametric tests focused on measures of fit that should be used instead. In order to assess the structural model different criteria are used (i.e. coefficient of determination (R-square), path coefficients and Stone-Geisser test of predictive relevance). The significance and stability of path coefficients is evaluated through re-sampling methods mainly bootstrapping and jack-knifing. Furthermore, Tenenhaus et al. (2004) proposed a global criterion of goodness of fit. The next section will explain the procedures of assessing the structural model.

7.4.3.1 Coefficient of Determination (R²)

Researchers should first investigate the Coefficient of determination (R²) when assessing the structural model; this coefficient indicates the percentage of the variance explained by the dependent variables (Hair et al., 2011). The importance of the R² depends on the research field (Hair et al., 2011). For example, an R² value of 0.2 is considered as relatively important in some disciplines like consumer behaviour, R² should be 0.75, in other disciplines such as marketing research 0.25 is perceived as weak 0.5 as moderate and 0.75 as substantial (Hair et al., 2011).

In auditor-client negotiation research, there is no specific threshold of high R^2 value. In addition, the very few studies e.g. Sahnoun and Zarai (2009) and Gibbins et al. (2010) have used CB-SEM and not PLS-SEM.

Dependent constructs in Table 33 reveals that R^2 value ranges from 0.078 and 0.149, these values fall within the acceptable range compared with other studies in the field of auditor-client negotiation research.

Table 33 R square

Construct	R Square
Accept	0,083
Adjust	0,123
Compromise	0,149
Contend	0,112
Integrative	0,078
Concede	0,138

7.4.3.2 Path Coefficients

In the PLS structural model, individual paths represent the standardised beta coefficients of ordinary least squares regressions (Hair Jr et al., 2016). Regression coefficient or beta (β) represents the estimated change in the dependent variable for a unit change of the independent variable (Hair Jr et al., 2014). The estimated regression coefficient indicates both the direction and the robustness of relationship between endogenous and exogenous variables (Hair Jr et al., 2014). The sign of path coefficients indicates whether the two variables are positively or negatively associated whereas the value of the path coefficients indicates the importance of this relationship.

T test and p values are used to assess the significance of individual path coefficients in SEM (Hair et al., 1998), these are computed through re-sample methods of bootstrapping or jack-knifing since PLS-SEM has no specific requirements for data

distribution. This study applies 5000 re-sampling for the bootstrapping resample method, which represents the recommended number of resamples in Smart PLS software. This large number of re-samples minimise the variability between samples (Hair Jr et al., 2014).

Bootstrapping was preferred over jack-knifing since it is considered more efficient, moreover jack-knifing is just an approximation of the bootstrapping method (Chin, 1998).

The result of estimation of path coefficients and their associated significance as represented by p values is presented in Table 36 as a part of the hypothesis testing procedures. The significance level applied in the current study is 10% ($p \leq 0.10$).

7.4.3.3 Predictive Relevance

The predictive relevance assessment of the path coefficients is a fundamental step in Structural Equation Modelling (Chin, 1998; Hair et al., 2011). In this context, Geisser (1974) and Stone (1974) proposed the Stone-Geisser's Q^2 criterion to evaluate the predictive relevance. Geisser (1975:320) clarified that "the prediction of observables or potential observables is of much greater relevance than the estimation of what are often artificial construct parameters". This criterion is considered as fitting as "hand in glove" to PLS (Wold, 1982).

Stone-Geisser's Q^2 criterion is computed using the blindfolding procedure, which consists of omitting a part of the data when estimating the parameters. Then, it uses these estimated parameters to estimate the omitted part of data. This process is repeated until every point of data is omitted and estimated (Chin, 1998). In general, the omission distance value (D) should be between 5 and 10, and the number of valid observations

should not be an integer when divided by the omission distance (D) (Hair Jr et al., 2014).

According to Chin (1998) and (Hair Jr et al., 2014), two forms of Stone-Geisser's Q2 criterion can be used i.e. cross validated communality and cross validated redundancy. "A cross-validated communality Q2 is obtained if prediction of the data points is made by the underlying latent variable score, whereas a cross-validated redundancy Q2 is obtained if the prediction is made by those latent variables that predict the block in question" (Chin, 1998: p.20). This means that with cross-validated communality Q2, only the observed variables for a particular latent variable are used to predict the observed variables for this endogenous latent variable. Whereas with the cross-validated redundancy, Q2 measures the structural model, ability to predict the observed variables based on their prediction of their latent variables through their respective structural equation relation (Tenenhaus et al., 2004).

Furthermore, cross-validated communality assesses the quality of measurement model whereas cross-validated redundancy measures the quality of structural model (Tenenhaus et al., 2004).

Hair Jr et al. (2014) recommend using CV redundancy as it considers the estimates of the measurement and structural model to predict data. Generally speaking, a positive Q2 indicates that the model has predictive relevance, while a negative Q2 indicates that the model in question does not have a predictive relevance (Chin, 1998).

The current research has adopted CV redundancy statistics using blindfolding procedures. The Table 34 indicates that all values of Q2 are positive except "Accept" and "ADJUST" which confirms the predictive relevance of the proposed model of this

study suggests that the relationships found are not only specific to this set of data (except for “accept” and “ADJUST”) but can be replicated to other sets of data.

Table 34 Predictive relevance

Construct	SSO	SSE	$Q_i^{1/2}$ (=1- SSE/SSO)
Accept	149.000	156.393	-0.050
Adjust	298.000	305.403	-0.025
Compromise	149.000	139.035	0.067
Concede	298.000	280.192	0.060
Contend	447.000	432.602	0.032
Integrative	149.000	148.150	0.006

7.4.3.4 Goodness of Fit

Contrary to the covariance based – Structural Equation Modelling CB-SEM, PLS-SEM does not apply an overall measure of goodness of fit (Hulland, 1999; Hair Jr et al., 2016). In this context, the objective of CB-SEM is to reproduce the observed covariance matrix using parametric estimation procedure, while PLS-SEM seeks to minimise the error or to maximise the explained variance in endogenous variables measured by the coefficients of determination R^2 (Hulland, 1999).

Some researchers have suggested criteria for goodness of fit, namely the Bentler-Bonnet fit index developed by Bentler and Bonett (1980) and the global criterion for goodness of fit developed by Tenenhaus et al. (2004). However, these criteria present several limitations mainly related to the assumption that parameters are estimated with the objective of minimising the difference between the observed and the reproduced covariance matrices (Hulland, 1999). On the other hand, using the model average R^2 and average communality for reflective model as a global criterion of goodness of fit is not appropriate when the model includes formative model or single indicator construct (Hair Jr et al., 2014). In addition, there is no consensus on what is the threshold of the

good fit criterion (R^2) (Hair Jr et al., 2016). Therefore, the current study does not use goodness of fit criterion as this is not appropriate for PLS-SEM technique, moreover, the conceptual model of this research includes formative measurement model and some constructs are measured using single measures (e.g., “bargaining power”, “client pressure”, “compromise” and “integrative”).

7.4.3.5 Multicollinearity

When two or more variables are highly correlated, they are said to be multicollinear. Naturally, researchers want the dependent and independent variables to be correlated but they want a very low correlation between the independent variables (Hair Jr et al., 2016). As multicollinearity affects the validity of the findings generated from the developed model, especially it may result in biased estimated coefficients in terms of both sign and magnitude (Hair Jr et al., 2014). High multicollinearity results in the reduction of the total variance explained. Furthermore, the value of the unique variance of the explanatory variables declines, making difficult the identification of their respective effects (Hair Jr et al., 2014).

In order to assess multicollinearity we examine the variance inflation factor (VIF) as discussed previously; this criterion assesses the strength of the linear relationship between predictors. The commonly used threshold of VIF is 10, in other words if the value of VIF is higher than 10, there is multicollinearity issues between the independent variables (Hair Jr et al., 2014).

Table 35 reports the VIF values between independent variables; it indicates that the largest value of VIF is 5.499. Overall, the results of the VIF confirm that there are no multicollinearity issues between the independent variables in this study.

Table 35 Multicollinearity

Construct	VIF
Accept	1,000
Adjust	1,087
Current ratio	3,876
Income	4,738
Litigation	2,352
Misstatement	1,376
Non-renewal threat	1,000
Quick Ratio	3,876
ER	1,000
ROE	1,000
Reputation	2,426
Sales	5,499
Total assets	1,390
Typical Auditor adjust	1,087
Compromise 1	1,000
Concede 1	1,805
Concede 2	1,805
Contend 1	1,151
Contend 2	1,331
Contend 3	1,289
Integrative 2	1,000
Inventory	1,000
FC	1,000
GVCE mechanisms	1,000

7.5 Hypothesis Testing

The objective of this section is to test and report the results of the research hypotheses, which are classified into three groups. The first group examines the association between Engagement risk and negotiation strategies as well as the pathways used by negotiators. The second group examines the association between client pressure with the negotiation strategy choice on the one hand and the pathways that lead to this choice. The third group examines the association between client pressure and negotiation strategies along with the pathways used by the auditors. Results are presented in Table 36 and the path coefficients are superimposed on the path diagram in Figure 7 for ease of interpretation.

Table 36 Paths coefficients

Pathways	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics ((O/STDEV))	P Values
I→P					
FS → ER1	0,025	0,038	1,305	0,019	0,985
FS → ER2	-0,748	-0,756	0,830	0,901	0,368
FS → ER3	0,123	0,021	0,900	0,137	0,891
Inventory → ER1	-0,301	-0,199	1,405	0,214	0,831
Inventory → ER2	0,406	0,268	0,930	0,436	0,663
Inventory → ER3	-1,051	-0,929	0,918	1,145	0,252
Liquidity → ER1	0,099	0,027	0,848	0,117	0,907
Liquidity → ER2	0,386	0,433	0,589	0,655	0,513
Liquidity → ER3	-0,246	-0,186	0,611	0,403	0,687
Profitability → ER1	-0,050	-0,092	1,049	0,048	0,962
Profitability → ER2	-0,375	-0,278	0,836	0,449	0,654
Profitability → ER3	0,528	0,446	0,755	0,699	0,485
P→J					
RISK					
ER1 → Accept	-0,067	-0,067	0,105	0,633	0,527
ER1 → ADJUST	-0,237	-0,230	0,117	2,019	0,044
ER2 → Accept	0,197	0,193	0,097	2,027	0,043
ER2 → ADJUST	0,282	0,279	0,111	2,551	0,011
ER3 → Accept	-0,197	-0,195	0,132	1,497	0,134
ER3 → ADJUST	-0,054	-0,054	0,131	0,416	0,677
PRESSURE					
PRESSURE → Accept	-0,089	-0,094	0,104	0,855	0,393
PRESSURE → Adjust	0,175	0,170	0,129	1,349	0,177
POWER					
POWER → Accept	0,108	0,108	0,101	1,064	0,287
POWER → Adjust	-0,105	-0,096	0,105	0,992	0,321
J→D					
Accept → Compromise	0,277	0,277	0,078	3,564	0,000
Accept → Contend	-0,295	-0,311	0,091	3,251	0,001
Accept → Integrative	0,218	0,215	0,075	2,926	0,003
Accept → Concede	0,309	0,312	0,084	3,681	0,000
ADJUST → Compromise	-0,031	-0,033	0,098	0,311	0,756
ADJUST → Contend	0,119	0,126	0,116	1,028	0,304
ADJUST → Integrative	0,042	0,044	0,114	0,369	0,712
ADJUST → concede	0,126	0,128	0,092	1,364	0,173
P→D					
RISK					
ER1 → Compromise	-0,120	-0,111	0,082	1,465	0,143
ER1 → Contend	0,061	0,064	0,116	0,525	0,599
ER1 → Integrative	0,054	0,061	0,097	0,557	0,578

ER1 → concede	-0,080	-0,088	0,102	0,786	0,432
ER2 → Contend	-0,007	-0,006	0,111	0,062	0,951
ER2 → Integrative	-0,051	-0,048	0,098	0,518	0,604
ER2 → concede	0,038	0,040	0,118	0,318	0,750
ER3 → Compromise	0,054	0,062	0,092	0,588	0,557
ER3 → Contend	0,019	0,013	0,107	0,180	0,857
ER3 → Integrative	0,162	0,164	0,089	1,823	0,068
ER3 → concede	0,030	0,035	0,086	0,347	0,729
PRESSURE					
PRESSURE → Compromise	0,293	0,283	0,090	3,235	0,001
PRESSURE → Contend	-0,044	-0,043	0,100	0,437	0,662
PRESSURE → Integrative	0,033	0,031	0,109	0,302	0,763
PRESSURE → concede	-0,046	-0,041	0,093	0,498	0,619
POWER					
POWER → Compromise	-0,070	-0,063	0,094	0,745	0,457
POWER → Contend	-0,040	-0,044	0,108	0,371	0,711
POWER → Integrative	-0,103	-0,103	0,096	1,076	0,282
POWER → concede	-0,157	-0,153	0,093	1,681	0,093
I → J					
FS → Accept	-0,361	-0,348	1,275	0,283	0,777
FS → ADJUST	-0,265	-0,369	1,169	0,227	0,821
Inventory → Accept	0,243	0,093	1,173	0,207	0,836
Inventory → ADJUST	0,305	0,200	1,061	0,287	0,774
Liquidity → Accept	0,180	0,219	0,863	0,208	0,835
Liquidity → ADJUST	-0,069	0,029	0,774	0,090	0,929
Profitability → Accept	-0,043	0,056	1,102	0,039	0,969
Profitability → ADJUST	0,057	0,171	0,928	0,062	0,951

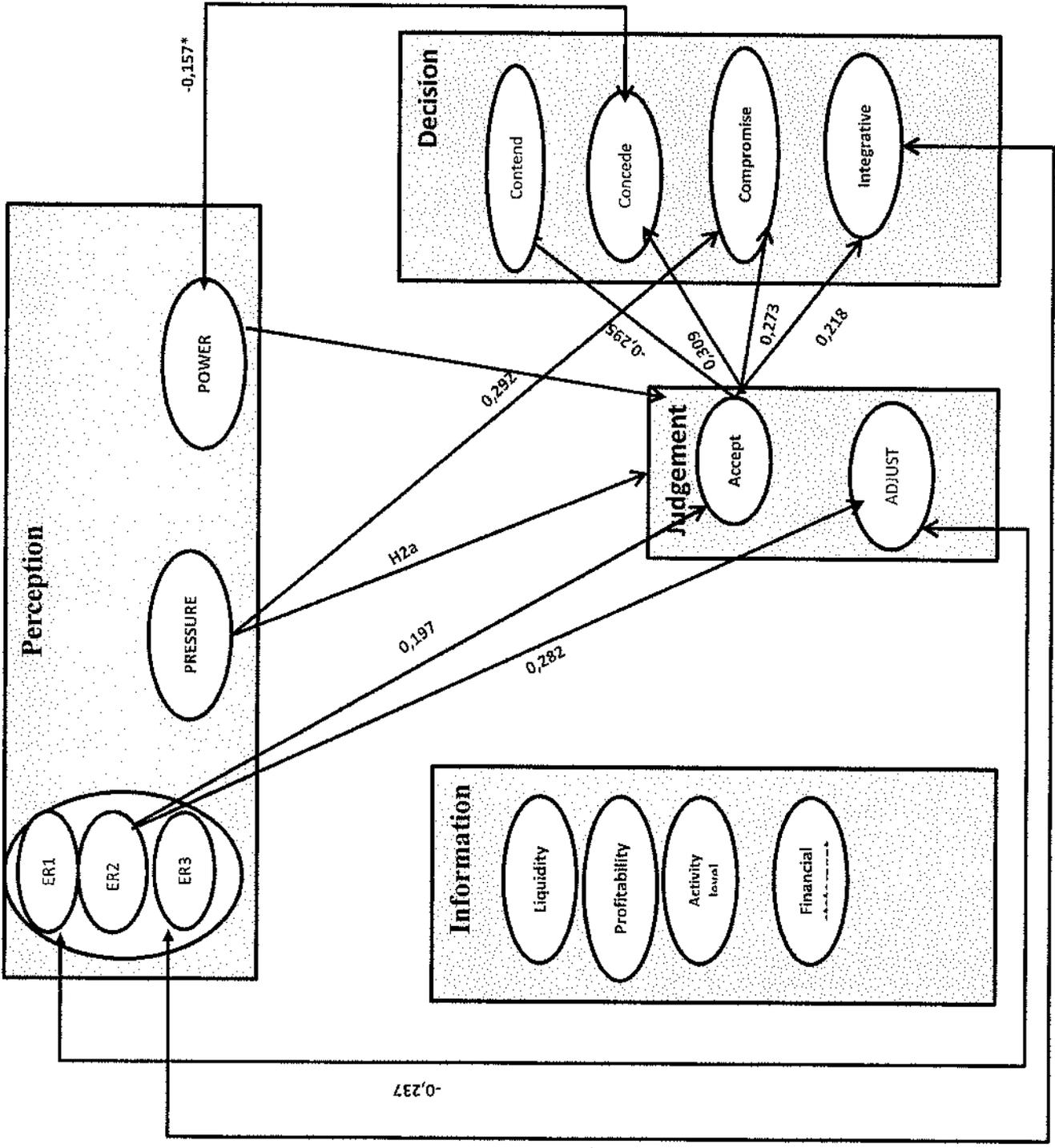


Figure 7 Results of Structural Model of auditor's negotiation strategies choice

*p<0.10, all others coefficients p<0.05.

Variables definitions in Figure 5.

7.5.1 Engagement risk

The study sought to establish that engagement risk (P) and financial information (I) would be associated significantly with the likelihood of accepting management alternatives and the amount required to be adjusted (J), which in turn affects the negotiation strategies decision choice (D). Furthermore, according to the throughput model, the engagement risk can influence the decision choice directly and the financial information (I) influences the engagement risk perception.

A structural model was developed to examine the association between engagement risk and negotiation strategies. This section presents the results of the effect of the engagement risk on auditors' choice on the one hand, and the pathways that lead to this choice on the other.

Financial information and engagement risk perception: I → P

Hypothesis 1a predicts that positive financial information is negatively associated with engagement risk perception. However, the results indicate that none of the financial information latent constructs affects the engagement risk ($p \geq 0.10$). Therefore, this hypothesis is not supported.

Engagement risk perception and judgement : P → J

H1b predicts when the client's engagement risk is perceived to be high; the auditor will be less likely to reject the aggressive client accounting policy choices and require smaller adjustments from the client to bring the accounting treatments into the conformance with GAAP.

As Table 5, Panel A shows, the measures of client's engagement risk were stated and scored so that a lower score on the latent variables "ER1", "ER2", and "ER3" indicates low engagement risk and a higher score indicates high engagement risk. Also the measures of auditor's acceptance were stated and scored so that a lower score on the latent variable Accept indicates the auditor would not accept management's alternative and a higher score indicates the auditor's would accept management's alternative. Our results are displayed in Figure 7 and discussed below in the format of (coefficient (standard error), p-value). As Figure 7 illustrates, we find a positive relationship between "ER 2" (recall that a higher score indicates high engagement risk) and "Accept" (0.197 (0.097), $p < 0.042$). However, paths from "ER1" to "Accept" and from "ER3" to "Accept" are not significant, therefore, when engagement risk is low, auditors reported they would not accept management's alternative.

Figure 7 also indicates a positive relationship between "ER2" and "adjust" (0.282 (0.113), $p < 0.013$). Thus, the riskier the client is perceived to be, the more the auditors agreed that they felt strongly committed to require adjustment. We also find a significant relationship between "ER1" and "ADJUST", however, this relationship is negative (-0.237 (0.112), $p < 0.036$), the riskier the client is perceived to be, the lower the adjustment amount to be required. Therefore, H1b is partially supported.

Judgement and negotiation strategies decision choice: J→D

H1d posits that greater acceptance of client alternative is more likely to result in the auditor employing conceding tactics and less likely to result in contending tactics. The relationship predicted in H1d is supported as there is a negative relationship between "ER2" and "Contend" (-0.295 (0.099), $p < 0.003$). In addition, we find support for the

relationship predicted between “ER2” and “concede” (0.309 (0.088) $p < 0.000$), Therefore H1d is supported.

H1e predicts that Greater acceptance of client alternative is more likely to result in the auditor employing Integrative strategies. Supporting H1e, we find a significant relationship in the direction predicted between “accept” and Integrative strategies (0.188 (0.083), $p < 0.024$).

H1f predicts that Greater acceptance of client alternative is more likely to result employing compromising strategies. We find support for the relationship predicted between “ER 2” and “compromise” via “accept” (0.276 (0.083) $p < 0.001$), therefore this hypothesis is supported.

H1d predicts that greater perceived engagement risk is more likely to result in auditors employing conceding tactics, compromising strategies and integrative strategies but less likely to result in contending strategies. We only find a direct marginally significant relationship in the direction predicted between “ER3” and integrative strategies (0.162 (0.088), $p < 0.068$), $P \rightarrow D$), therefore this hypothesis is partially supported.

To summarize, our results show that more perceived engagement risk leads to a greater intention to use the distributive strategy “contend” and a lesser intention to use the distributive strategies, “Concede”, “compromise”, and integrative strategies. Furthermore, auditors use two pathways when they decide about negotiation strategies; these are $P \rightarrow J \rightarrow D$ or $P \rightarrow D$.

7.5.2 Client pressure

This section presents the results of the effect of client pressure (P) on the auditor likelihood of accepting management’s alternative and the amount required to be

adjusted (J) in a first stage. Then in a second stage, judgement (J) can affect negotiation strategies (D).

Client pressure perception may also affect directly the negotiation strategies choice (D)

Client pressure and judgement: P→J

H2a predicts that high client pressure on the auditor to accept aggressive accounting treatments will result in the greatest likelihood of an auditor rejecting the client's proposed accounting policy requiring a higher adjustment in order to find the accounting to be in accordance with GAAP. This hypothesis is not supported since I did not find any significant relationship between client pressure and "accept" nor with "adjust".

Judgement and compromise: J→D

H2b predicts that higher acceptance is more likely to lead the auditor to use "compromising" negotiation tactics (i.e., a positive relationship). This hypothesis is not supported since we did not find any significant relationship between "accept" nor "adjust" and compromising strategies.

Client pressure and compromising strategies: P→D

H2c predicts greater perceived client pressure is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship). Figure 7 shows a significant association in the predicted direction between "PRESSURE" and "Compromise" (0.292 (0.088), $p < 0.001$) therefore H2c is supported, and auditors only use P→D pathway.

7.5.3 Bargaining power

This section presents the results of the effect of bargaining power on the auditor likelihood of accepting management alternative and on the amount to be adjusted, which lead to negotiation strategies decision choice (D). Besides, the results of the direct effect of bargaining power on the negotiation strategies.

Bargaining power and judgement: P→J

H3a predicts that greater perceived bargaining power is more likely to lead lesser willingness to accept aggressive client accounting policy choices and to the requirement for higher adjustments to bring the accounting into conformance with GAAP. There is no significant relationship between bargaining power and both “accept” and “adjust”. Hence, H3a is not supported and auditors do not use judgement when they decide about which negotiation strategy to use.

Judgement and concession: J→D

H3b predicts that higher acceptance of management’s alternative leads to “conceding” negotiation strategy. This hypothesis is not supported since there is no significant relationship between “ACCEPT” nor “ADJUST” and “concession”.

Bargaining power and Concession: P→D

H3c predicts that weak perceived corporate governance leads to “conceding” negotiation strategy. Figure 7 shows a marginal association in the predicted direction between “Governance” and “Concede” (-0.157 (0.089), $p < 0.080$), confirming thereby H3c and the direct effect of bargaining power on the use of “conceding” strategy.

Information and Judgement

Finally, we posited that financial information influence auditor's judgement about the likelihood of rejection of management's alternative and the amount to be adjusted, There is no significant relationship between financial information constructs and judgement (i.e. acceptance of management's alternative and audit adjustment) therefore this hypothesis is not supported.

7.6 Summary

This Chapter presented the procedures followed to assess the measurement, the structural model, and the results of hypotheses testing. These procedures started with assessing data reliability and validity. Once these have been validated, this chapter proceeded with data examination, including checking the missing data, outliers and testing the normality assumption. In addition, the descriptive statistics were presented for the research constructs. The rest of this Chapter presented the results of the structural model analysis and hypotheses testing using PLS-SEM. The procedures of assessing the structural model involved using path coefficients, R^2 , t test, predictive relevance.

Chapter 8: Discussions

8.1 Introduction

The objective of this chapter is to discuss the results of hypotheses testing and to link it to the previous research in auditor-client negotiation. The discussion of the empirical results reported in the previous chapter will analyse in a first stage the set of hypotheses focusing on the effect of financial information, engagement risk perception, client pressure perception and bargaining power perception. Then in a second stage, this chapter will discuss different negotiation strategies that auditors have employed and the relationship with the ethical pathways.

Before making any consideration regarding the independent variables, it should be noted that on average auditors do not seem to accept the proposed management's alternatives (2.199). In fact, they require a high amount for both the average amount they require the client to make (i.e. Adjust (3.980)) and the average amount they think a typical auditor would require (i.e. Typical adjust (3.207)). These findings suggest that overall auditors are not likely to concede with the client, and this is confirmed by the descriptive statistics which indicate average scores of concede 1 (2.31) and concede 2 (2.715) lower than the average statistics for contend indicators, that is contend 1 (4.701), contend 2 (4.118) and contend 3 (5.731).

This is consistent with recent research in the auditor-client negotiation field (Bamber and Iyer, 2007; Koch and Schmidt, 2010). However, although the ranking of using "contending" strategies is more important than the ranking of using "conceding" strategies, auditors still appear to concede to client management to some extent despite their proposed audit adjustment, which would infer less conceding strategies used by

auditors in this study. This suggests these two decisions are made independently. Therefore, it appears that the auditors did not use the audit adjustment and the likelihood of acceptance as a bridge for bargaining tactics when they concede.

The difference between the amount that auditors require to be made (Adjust) and the amount they believe a typical auditor would require is negligible (Typical adjust). These two findings indicate that auditors might have reported a typical expected attitude toward audit adjustment in order to avoid being viewed as unprofessional (Ng and Tan, 2003). This indicates that auditors feel more comfortable with revealing their negotiation strategies, than with revealing the amount to be made. Further, it provides some preliminary support that the auditors are reticent about revealing their acceptance of the client's alternative.

8.2 Financial information

The results relating to the first phase of the throughput model show that auditor's perception of engagement audit risk is not affected by financial information. Therefore, participants in this study do not consider financial information in their decision-making process. Future research is needed to confirm this as it is quite unlikely that auditors do not use financial information when they make decisions.

Johnstone (2000) have investigated the relationship between client's financial performance (i.e. client's business risk) and auditor's engagement risk (auditor's business risk) and find a positive significant relationship ($\beta = 0.27$).

Another finding related to the first stage of the throughput model concerns the relative influence of financial information (I) and engagement risk perception (P) on auditor's judgement of the likelihood of accepting the client's management alternative (J). The results show that the relationship between engagement risk perception and judgement is

significant; however, the relationship between the financial information and judgement is not significant. Previous research has not investigated the relationship between financial information and auditor's adjustments directly; therefore, these findings provide preliminary evidence on this relationship.

Overall, these results show that the participants in this study directly use their perception of client's engagement risk with their judgement about the likelihood of accepting the management's alternative without the need to incorporate financial information.

8.3 The effects of engagement risk

8.3.1 The effect of engagement risk on judgement

Findings of this study about the effects of engagement risk on ADJUST are mixed. In fact while there was a negative relationship between ER1 (i.e. Litigation, Reputation and misstatement) and ADJUST, there was a positive relationship between (ER2 i.e. overall engagement risk) and ADJUST. In addition, no significant relationship was found between ER3 (i.e. Financial condition) and ADJUST is found. Although the indicators for these latent variables have been validated by the theory and previous research as valid in measuring engagement risk (Johnstone, 2000; Brown and Johnstone, 2009), they seem to have been interpreted differently by participants in this study. This supports the factor loadings of these indicator (see section 7.2.1.1). Therefore, the effect of engagement risk on accept is consistent for all latent constructs, as there is a positive relationship between ER2 and accept, on the other hand there is no significant relationship neither between ER1 and accept nor between ER3 and accept.

Surprisingly, the effect of ER2 on ADJUST contradicts its effect on accept. In fact while auditors report they will accept client's alternative when the engagement risk is

high, they report higher amount of audit adjustment. This could be explained by the fact that auditors are more careful when they deal with numbers.

The response of auditors' to high engagement risk appears to be consistent with Brown and Johnstone (2009) which suggest, the higher the engagement risk is, the higher the probability that the auditor will accept management proposed treatment for absolute inventory. This tends to suggest that they might be influenced by the clients' best alternative in a high engagement risk condition. However, the response of auditors to lower engagement risk could not be explained, that is they stand tough in face of low engagement risk and as a result, findings the auditors are more conservative and cautious.

Previous research studying the impact of engagement risk on auditor's judgment indicates that high engagement risk results in auditor's being more conservative (Hackenbrack and Nelson, 1996). However, the effect found in the current study converges with the motivated reasoning explanation of auditors' behavior, which suggests that individuals search and interpret information in a way that enables them to reach the particular conclusion they want to achieve. Although auditors are required to be objective in their judgement and to choose the most conservative option as recommended by GAAP, the findings in this study indicates that auditors might give in to client's pressure and accept his aggressive reporting alternative. This will have serious consequences on the stakeholders who expect the value of financial statements to reflect the true economic value of the firm.

An alternative explanation for the positive correlation between engagement risk and accept is the ambiguous and highlights the subjective nature of the issue under negotiation. In fact, previous research suggests that when GAAP do not provide clear

guidelines for a particular accounting treatment, auditors might be induced to interpret the accounting standards in line with their client preferences (Hackenbrack and Nelson, 1996). Furthermore, Nelson and Kinney Jr (1997) report that auditors do not select the most conservative option when the accounting issue is ambiguous. Similarly, in Gibbins et al. (2001)'s study, audit partners reported that they think their bargaining power and their ability to withstand client management's alternative is affected by GAAP ambiguity. Moreover, Thompson and Loewenstein (1992) and Kunda (1990) suggests that motivation reasoning results in an impartial interpretation when the accounting issue is not clearly defined by GAAP.

These findings show that auditor's judgement about the likelihood of accepting the management's alternative mediates the effect of the engagement risk perception on the negotiation strategy decision choice. Thus, while auditors screen clients based on the engagement risk characteristics to make in the first stage the judgement about accepting client's accounting treatment and decide in a second stage about the negotiation strategy. In other words, the negotiation strategy decision depends not simply on the perception of the engagement risk, but on auditor's evaluation of how those risks influence the likelihood of accepting the management's alternative.

8.3.2 The effect of engagement risk on negotiation strategies

Greater acceptance of the client management's alternative, results in more conceding and less contending strategies, as posited by H1b. this indicates that auditors select negotiation strategies that are consistent with their judgement. In other words, the more auditors are willing to accept client's alternative, the more they acquiesce to their wishes and employ soft negotiation strategies, and the more they are opposed to their client's alternative, the more they use contending strategies.

High engagement risk results in greater acceptance of client's alternative, which results in its turn on the auditor employing integrative strategies. In fact, the difficult situation induced by high engagement risk leads auditors to using integrative strategies to resolve the negotiation strategies. This is especially true when they cannot use contending strategies as they have an ongoing interest in keeping the client happy.

Another significant negotiation strategy that auditors use is compromising strategy. This indicates that auditors use compromising strategy to facilitate negotiation when both parties have their own preferences. However, they are ready to move from their position in order to achieve the best negotiation outcome.

Engagement risk perception leads directly to integrative strategies without the need to use their judgement about the likelihood of accepting management's alternative or the amount required to be made by the client. However, this perception does not affect auditors' use of compromising, contending and conceding strategies.

These findings imply that studies examining the effect of engagement risk on other auditing outcomes should measure both the effect of these risks on the decision of interest and the potential mediating effect of auditor's judgement.

8.4 The effects of client pressure

8.4.1 The effect of client pressure on judgement

The statistical analysis did not support the predicted influence of client pressure perception on judgement whether on the likelihood of acceptance or on the amount required to be adjusted. It is possible that auditors do not bring judgement to the forefront of their decision making process. It appears that high concern for the client does not preclude concern for others in this study. Theoretically, this is surprising since

previous studies have found a significant impact of client pressure on accepting the client's position (Hatfield et al., 2008). Perception of client pressure involves the auditor concedes to client's expectations.

8.4.2 The effect of client pressure on negotiation strategies

The impact of client pressure on the use of compromising strategy suggests that auditors perceive non-renewal threats as a contending position by the client. Thus, they respond by using compromising strategies. The client pressure seems to be salient when participants assess the latent constructs representing judgement, but when assessing the likelihood of using compromising strategy, client pressure has an influence on compromising strategy.

Experimental findings suggest that there is a positive relationship between the use of compromising strategies and the client pressure perception. The more the auditors are unsure about the renewal of their contract, the more they employ compromising strategies. This is explained by the fact that auditors are willing to move from their preferred position given the high client pressure. However, they are expecting the client to behave the same way and to move from their preferred position as well. As expected conceding is not an option in this situation given that auditors usually have guidelines on how to withstand client pressure (Knechel and Vanstraelen, 2007). At the same time, auditors cannot afford contending strategies, as this would have a greater probability that the auditor will lose the appointment next year.

In terms of motivated reasoning, moving from one's preferred position is made possible by searching and interpreting evidence that supports the conclusion that both parties want to achieve.

The perception of client pressure does not have an impact on the judgement of auditors' about the acceptance of the client's position and the amount of the adjustment to be made. This means that auditors do not use the judgement component when they decide about the negotiation strategy, and they directly use their perception about the client pressure when they decide to compromise. This indicates that auditors make easily the decision when they are threatened by the non-renewal of the contract.

These results are in line with previous research that suggests that auditors may use reciprocity strategies to reduce the pressure from their clients and mitigate the client's resistance. For example Sanchez et al. (2007), who studied the impact of reciprocity strategy. However, the current research findings are not consistent with previous research which has shown that as client pressure increases, auditors are more willing to accept client's accounting treatments (Hatfield et al., 2011).

My study is one of the first studies to provide evidence that client pressure does not result in auditor's conceding to their client wishes. In fact, they consider using softer negotiation strategies assuming that their clients will reciprocate. These findings indicate that SOX reforms, which have an objective of improving auditor's resistance to client pressure, are somehow effective.

8.5 The role of the audit committee

Research suggests that the audit committee strength influences the auditor's judgement of acceptance of the client's preferred position and the amount to be recorded. However, findings of this study do not support this proposition.

Research results show that a weak audit committee results in auditors choosing conceding strategies therefore, a weak audit committee may decrease the auditor's confidence about the support they may receive. However, the opposite does not hold

true for strong corporate governance mechanisms, as there is no significant relationship between contending strategies and audit committee strength. This suggests that when auditors infer that the audit committee is efficient and supports financial statements showing the real economic representation of the client, they are still avoiding contentious strategies and seem to pursue good relationship with management.

It is also interesting to note that bargaining power only had an effect in concessionary behaviour. Overall, the role of the audit committee does not seem to support recent studies that report audit committees are more questioning and diligent (Gibbins and Jamal, 2005; Cohen et al., 2007). Moreover, auditors still seem to believe that the audit committee follow management preferences, despite SOX reforms (Fiolleau et al., 2013). These findings are consistent with general negotiation literature research, which indicates that weak negotiators adopt soft negotiation strategies as compared to more powerful ones. For instance, it does not have an impact on judgement neither on contending behaviour. However, when the audit committee seems to side with the management, auditors interpret this as management biases are not questioned by audit committee

8.6 Auditor negotiation strategies and throughput Model pathways

This section discusses the different negotiation strategies that auditors have employed and the relationship with the ethical pathways depicted by Throughput Model theory. Table 37 below illustrates these relationships.

Table 37 Negotiation strategies and relevant decision- making pathways

Negotiation strategies	TP Pathways
Contending	P→J→D Deontology
Conceding	P→D Ethical Egoism
Compromising	P→J→D Deontology
Integrative	P→D Ethical Egoism
	P→J→D Deontology

8.6.1 Contending strategy

As previously defined contending strategies involves imposing one’s position by using tactics such as threats and harassment. The findings indicate that auditors use this strategy when they negotiate with their clients. Furthermore, only engagement risk perception affects significantly the use of this strategy via its effect on auditor’s judgement about his acceptance of management’s accounting treatment. Therefore, the pathway that auditors use when they decide to contend is $P \rightarrow J \rightarrow D$ (see figure 8 below). This study shows that auditors threaten clients with qualifying the audit report, unless the client accepts the accounting solution that (s)he has suggested. Decision makers adopting this style mostly consider the deontology pathway, which is characterized by a focus upon adherence to specific rules. Therefore, engagement risk perception (P) will influence the extent to which the auditor accepts the management’s accounting treatment (J) before a decision choice about contending is made (D).

Accordingly, auditors’ decision choice formation can be strongly influenced by their perceived self-interest, regardless of the financial information that could have an impact on the perception and on the judgement. Moreover, auditors in this case may decide to use hard strategies and contend (D) in order to reach their most preferable outcome.

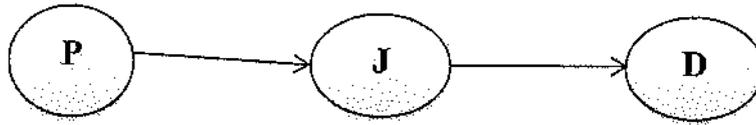


Figure 8 Pathway of contending strategy

8.6.2 Conceding strategy

This strategy is characterized by a low concern for self and high concern for others, and results in a lose-win outcome. Negotiators in this situation may neglect their interests in order to allow the other party to win (Pruitt and Carnevale, 1993). Conceding thus “involves changing one’s position to provide less benefit to oneself and therefore more benefit to the other party” (Pruitt and Carnevale, 1993:28). The findings provide evidence that auditors use conceding strategies. Like for the contending strategy, this strategy is explained by the deontology pathway $P \rightarrow J \rightarrow D$ as High engagement risk leads to more acceptance of management’s accounting treatment, which in turn leads to more conceding strategies. Auditors use the ethical egoism pathway when they decide to concede to their clients. In this pathway auditors downplay any relevant information and judgement about the management’s accounting treatment. Their decision is driven automatically by their perception about the strength of audit committee, thus auditors, perceiving that they are not receiving support from the audit committee, decide to use conceding strategies with the clients. Figure 9 below illustrates the pathways used for this strategy.

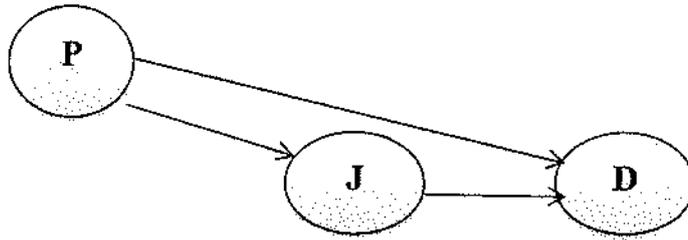


Figure 9 Pathways used for conceding strategy

8.6.3 Compromising strategy

This strategy is characterized by concern for self as well as others. It leads to a no-win, no-lose outcome and can be regarded as a mid-point between the contending and conceding strategies because both negotiators move from their most preferred positions towards an “in between” solution. Pruitt (1983) suggests that this strategy can be regarded as integrative given that it involves, to some extent, elements of both assertiveness and cooperativeness.

According to the pathway used by auditors in this study, “compromising” is explained again by the deontology pathway $P \rightarrow J \rightarrow D$. Therefore, high engagement risk perception (P) leads to more acceptance of management’s alternative, which in turns leads to more compromising strategies. Auditors use the ethical egoism pathway as represented by $P \rightarrow D$. The client pressure perception leads automatically to compromising strategy, in other terms when auditors perceive that they are threatened by non-renewal threat, they decide automatically to compromise, taking into consideration the guidelines of the audit profession, which recommend resisting client pressure. Therefore, the next best

option for auditors is to compromise. Figure 9 illustrates the pathways used for this strategy.

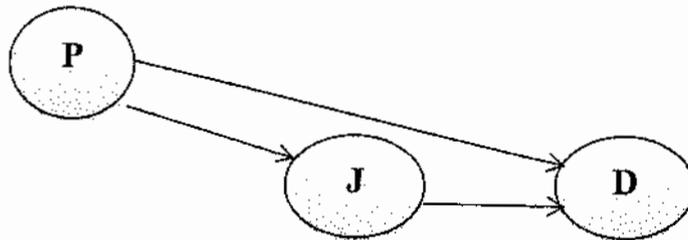


Figure 10 Pathways used for compromising strategy

8.6.4 Integrative strategies

These strategies view conflict resolution by exploring differences and looking for alternative solutions from those each party initially considered (Rahim et al., 1992).

The results show that auditors use the deontology and the ethical egoism pathways when they choose to use integrative strategies, therefore when auditors perceive that the engagement risk is high (P) they are more willing to accept management accounting treatment (J), thus leading to using integrative strategies (D).

In addition, engagement risk perception allows auditors to automatically reach a decision concerning using the integrative strategies. See figure 11 for illustration of the pathways of this strategy.

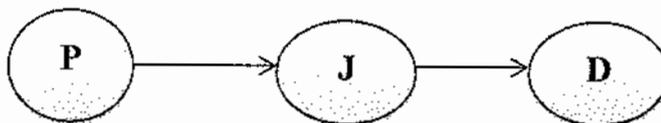


Figure 11 Pathways used for integrative strategy

8.7 Summary

In this chapter, I analysed the findings reported in the previous chapter. I linked these results to the literature related to auditor-client negotiation. The results show that only engagement risk perception influences auditor's propensity to accept aggressive accounting treatments of the client. This in turn influences the use of all the negotiation strategies. This finding is explained by the motivation reasoning perspective. On the other hand, client pressure only has effect on compromising strategies while bargaining power influences the concessionary strategy of auditors. Moreover, two dominant decision making pathways are used by auditors, i.e. $P \rightarrow J \rightarrow D$ and $P \rightarrow D$.

Chapter 9: Conclusions

9.1 Introduction

This thesis aims to contribute to the existing literature of auditor-client negotiation studies by casting new light on the decision-making process of auditors when they resolve contentious accounting issues. In part, this thesis was motivated by the argument, that negotiation is a common practice in auditing (Bazerman and Neale, 1993), and that more evidence needs to be provided in order to improve negotiation skills of auditors. Inspired by the rich and fruitful findings on the implications of the generic negotiation theory and the Throughput model theory, this thesis seeks to bring the decision making process to the field of auditor-client negotiation research and provide preliminary empirical results concerning their plausible implications.

9.2 Overview

After presenting the background of the research and the conceptual foundation in Chapter 1, Chapter 2 offered a general review of generic negotiation research and the underpinning theories, focusing on the most pertinent lines of research to the audit context. It then presented a general review of the main research trends in the field of auditor-client negotiation research. I relied specifically on Gibbins et al. (2001) framework and grouped research into three main groups : studies related to contextual features, those related to interpersonal relationships and those related to parties abilities.

Existing research has empirically investigated the effects of the above-mentioned factors on negotiation outcomes and on the negotiation strategy choice. The research concluded that the auditor may have the required knowledge, experience, or traits that

enable them to identify a misstatement; however, s/he may decide not to require the adjustment because of the different pressures in the specific context related to the environment or to the client characteristics. Similarly, the auditing environment may encourage the auditor to require the adjustments (e.g. high engagement risk), but the auditor fails to persuade the client to make the audit adjustment because they lack the knowledge or the experience to negotiate with the client. The Gibbins' Model is especially insightful when examining the factors that affect auditor-client negotiation. In fact it considers the potential interactions between parties' characteristics such as knowledge, experience, and ability, and environmental characteristics such as engagement risk, nature of the accounting auditing standards and combines them with the characteristics of the role of the auditor-client relationship to explain the negotiation performance and outcomes.

This chapter ended by focusing on research related to negotiation strategies, which are very similar to generic negotiation strategies (i.e. they are divided into two main groups: distributive and integrative).

Chapter 3 then proposed plausible implications and suggested distinct effects of conflict of interest on negotiation. How bargaining power might be anticipated in the context of auditor client negotiation was also discussed in this chapter. This chapter explained why given the same audit issue, auditors use different negotiation strategies while faced with different contexts.

When they cannot ignore conflicting evidence and the accounting issue at hand is complex auditors often engage in distribution strategies (conceding or contending) and less in integrative strategies and this depends on their degree of self-interest. That is, if their self-interest is threatened of increased litigation exposure they will use contending

strategies and they will threaten to qualify audit reports if the clients do not record audit adjustments. On the other hand, auditors chose to concede to their client's preferences if they are threatened with losing their clients.

The greater the auditor's power relative to the clients, the more adjustments they should be able to claim and the better the financial statements' quality. This is why accounting regulatory reforms are replete with recommendations to improve auditor's power position (e.g., SOX, 2002).

Yet, Auditors who wish to improve their power should realize that power may be influenced by a wide range of factors, related to the environment in which they operate their abilities and those of their counterparts.

Chapter 4 has discussed the judgement decision making in auditing and presented the Throughput model theory and how this model views the negotiation. Research questions to be addressed in this thesis and the hypotheses developed and tested in experiments are outlined and justified in chapter 5 (as summarized in Table 4, presented at the end of Chapter 5).

Chapter 6 has set out and explained the research methodology used in this study. In line with previous studies, we simulated an audit scenario using abstracted settings to reduce the level of complexity in the experiments. Case materials have been designed inspired by Kleinman and Palmon (2000)'s published case that portrays a concrete auditor-client negotiation case and some changes have been made to the original case since it was published and most importantly to include the specific issues we wanted to investigate. The results and findings of the experiments have been reported and discussed in Chapter 7 and 8.

This chapter starts with a summary and discussion of the main findings of this study. It then outlines the contribution of this thesis to existing literature in section 9.3. In sections 9.4 and 9.5, research contributions are presented and policy implications and are drawn from the key findings of the experiments reported on here. Finally, in section 9.6, following a discussion of the limitation of this thesis, some suggestions for future research are offered.

9.3 Findings of this study

This study examined the impact of motivational factors (i.e. the effect of engagement risk, and the client pressure) and auditor bargaining power (i.e. the effect of audit committee strength) along with financial information on auditor's acceptance of management's alternative and on auditor negotiation strategies. Furthermore, it studied the decision-making pathways that auditors use when they adopt a particular negotiation approach. An overview of the findings and a general discussion on their practical implications are provided below.

Findings on the effect of financial information on engagement risk perception (I→P)

These results show that the participants in this study do not use financial information in their perception of client's engagement risk nor in their judgement about the likelihood of accepting the management's alternative, therefore I→P pathway is not validated.

The effect of engagement risk on auditor's judgement about the acceptance of management's alternative and the amount required to be adjusted (P→J)

Findings of this study about the effects of engagement risk on adjust are mixed. In fact, while there was a negative relationship between ER1 (i.e. Litigation, Reputation and

misstatement) and adjust, there was a positive relationship between ER2 (i.e. overall engagement risk) and adjust and no significant relationship between ER3 (Financial condition) and adjust. However, the effect of engagement risk on accept is consistent through all latent constructs, as there is a positive relationship between ER2 and accept, on the other hand there is no significant relationship between ER1 and accept nor between ER3 and accept.

Auditor's acceptance of management's alternative influences auditor's negotiation strategies decision choice. The more auditors are willing to accept the client's alternative, the more they acquiesce to their wishes and employ soft negotiation strategies, and the more they are opposed to their client's alternative, the more they use contending strategies.

On the other hand, the difficult situation induced by the high engagement risk makes auditors use integrative strategies to resolve the negotiation strategies. This is especially true when they cannot use contending strategies as auditors have an ongoing interest in keeping the client happy.

Furthermore, auditors use compromising strategy to facilitate the negotiation when both parties have their own preferences, and they are ready to move from their position in order to achieve the best negotiation outcome.

Engagement risk perception leads directly to integrative strategies without the need to use the judgement about the likelihood of accepting management's alternative or the adjustment amount required to be recorded by the clients. However, this perception does not directly influence auditors' use of compromising, contending and conceding strategies.

To summarize, our results show that more perceived engagement risk leads to a greater intention to use the distributive strategy contend and a lesser intention to use the distributive strategies, concede and compromise, and integrative strategies. Furthermore, auditors can use two pathways when they decide about negotiation strategies; these are $P \rightarrow J \rightarrow D$ or $P \rightarrow D$.

Client pressure

This study also tested the effect of client pressure (P) on the auditor likelihood of accepting management's alternative and the amount required to be adjusted (J) in a first stage which in turn affects the negotiation strategies choice (D) on one hand or directly the effect of the client pressure (P) on the negotiation strategies choice (D).

Findings of this research did not support the predicted influence of client pressure perception on judgement whether on the likelihood of acceptance or on the amount required to be adjusted. Furthermore, we did not find any significant relationship between neither accept nor adjust and compromising strategies, therefore the path $P \rightarrow J \rightarrow D$ is not validated.

However we found a significant positive relationship of client pressure on compromising strategy consequently, the path $P \rightarrow D$ has been validated.

Bargaining Power

Finally, the current study examined the effect of bargaining power on the auditor likelihood of accepting management alternative and on the amount to be adjusted. Besides, the direct effect of bargaining power on the negotiation strategies. Statistical findings did not find a significant relationship between bargaining power and both accept and adjust. Hence, auditors do not use judgement when they decide about negotiation strategies. Furthermore, there is no significant relationship between

ACCEPT nor ADJUST and concession. Therefore, $P \rightarrow J \rightarrow D$ pathway was not supported.

This study showed that weak perceived corporate governance leads to conceding negotiation strategy as there was a marginal significant association in the predicted direction between Governance and Concede, consequently $P \rightarrow D$ pathway has been validated.

Overall, a weak audit committee results in auditors choosing conceding therefore, a weak audit committee may decrease the auditor's confidence about the support they may receive. However, the opposite does not hold true for strong corporate governance, as there is no significant relationship between contending strategies and audit committee strength and the likelihood of using these strategies.

Auditor negotiation strategies and Throughput model pathways

Decision choice formation about pursuing contending strategies is generated by the deontology pathway ($P \rightarrow J \rightarrow D$). In particular, engagement risk perception (P) influences the extent to which the auditor accepts the management accounting treatment (J) before a decision choice about contending is made (D).

Conceding strategy is explained by the deontology pathway $P \rightarrow J \rightarrow D$. Particularly low engagement risk leads to a more acceptance of management accounting treatment, which in turn leads to more conceding strategies. Furthermore, auditors use the ethical egoism pathway $P \rightarrow D$ when they decide to concede to their clients. In this pathway auditors downplay any relevant information and judgement about the management accounting treatment, their decision is driven automatically by their perception about the strength of audit committee, thus auditors perceiving that they are not receiving support from the audit committee decide to use conceding strategies with the clients.

Compromising is explained by the deontology pathway $P \rightarrow J \rightarrow D$. Therefore, high engagement risk perception (P) leads to more acceptance of management alternative, which in turns leads to more compromising strategies. Auditors use the ethical egoism pathway as represented by $P \rightarrow D$, the client pressure perception leads automatically to compromising strategy. In other terms, when auditors perceive that they are threatened by non-renewal threat, they decide automatically to compromise.

Integrative negotiation approach is explained by the deontology pathway and the ethical egoism pathway therefore when auditors perceive that the engagement risk is high (P) they are more willing to accept management accounting treatment(J), this lead to using integrative strategies (D). In addition, engagement risk perception allows auditors to reach decision automatically concerning the integrative strategies use.

9.4 Contributions

This research provides an important extension to the formulation of auditors' negotiation strategies by integrating negotiation research and Throughput model theory into a theoretical framework. It develops a model that incorporates work on general negotiation (Pruitt and Carnevale, 1993), auditor-client negotiation (Gibbins et al., 2001) and Throughput modeling (Rodgers, 1997).

The main purpose of this thesis is to explore and promote the applicability of the throughput model theory in the auditor-client negotiation context and to provide first empirical evidence on the decision-making pathways that auditors use when they decide about negotiation strategies.

Up to date, no study has ever applied the Throughput model theory into auditor-client negotiation research. This thesis conducted experiments to test the potential influence of perception of contextual features (P) and information (I) on auditor's judgement (J) and

negotiation strategies decision choice (D) and provided evident support for the use of two dominant pathways, notably the deontology pathway $P \rightarrow J \rightarrow D$ and ethical egoism pathway $P \rightarrow D$. Therefore, it has contributed to the existing knowledge on decision-making issues in auditor-client negotiation research and research methodology by providing evidence of the influence of perception on judgement, which in turns affects decision choice; on the other hand, perception might lead directly to the decision choice. Given same case accounting issue, individuals reach different judgments when their perception is manipulated.

These findings demonstrate that motivational factors and bargaining power influence auditor's negotiation strategies. This thesis contributes to the stream of audit literature that argues that environmental factors and cognitive bias, play an important role in auditors judgement and the way they resolve contentious accounting issues (Bamber and Iyer, 2007; McCracken et al., 2008).

Although some preliminary research had already established that engagement, client pressure and audit committee strength affects auditors' concession strategies and the resulted outcome (Ng and Tan, 2003; Hatfield et al., 2008; Brown and Johnstone, 2009). This study makes a deeper examination of negotiation approaches by examining the overall set of negotiation strategies i.e. concession, contending, compromising and integrative.

These findings contribute to the research related to "self-serving bias" of auditors (Moore et al., 2006; Nelson, 2006). The findings of this study show that Moore et al. (2006) are overstating this bias. The negotiation case scenario used by this research activated self-serving incentives as suggested by Moore et al. (2006), however auditors

did not concede when they are faced with high client pressure and used compromising strategies instead.

9.5 Practical Implications

The results of this study have a number of implications for audit practice. Particularly, auditors need to be fully aware of the effect of engagement pressure, client pressure and the strength of the audit committee. For instance, special attention needs to be given to clients with weak audit committee so that they do not concede to their client wishes.

Exploring the factors that influence the negotiation strategies, adds insights to the audit profession and sheds light on the approaches that can be adopted by auditors in order to achieve the best negotiation outcome and to preserve positive relationships with their clients. From a research perspective, the findings of this study call for further research into how engagement risk should be evaluated. We suggest that a more detailed and global assessment of engagement risk needs to be developed.

Although the calls for more conservatism in auditor's judgements, the current study shows that auditors are induced to accept client's aggressive accounting under certain circumstances.

Furthermore, findings of this research have several implications for practitioners and regulators with regard to the audit committee. In fact, the association between auditors' concession strategies choice and audit committee strength has positive indications; it appears the reinforcement of the audit committee role is adequate; therefore, SOX reforms are indeed effective. Given this, audit committees should be improved by containing more financial expert members for example.

9.6 Limitations and future research

This research presents some limitations, which offer opportunities for future auditor-client negotiation research. First, we studied auditors' intention of pursuing a negotiation approach and their planned judgement. This presents an important limitation, in fact actual negotiation that might happen between auditors and client management could be different from the intended negotiation, therefore observing interactive dyadic negotiation could be an avenue for future research in negotiation. This will offer new insights about what is going on in the negotiation process. It is worth noting that this approach has its own limitations, most importantly the noise that might be due to others factors, which we cannot control and the important cost of gathering such busy professionals (i.e. audit partners and CFOs) at the same time.

Our results show that, auditors are more willing to accept clients' aggressive accounting treatments under certain contextual features. This might be done in order to signal their cooperation to the clients and does not imply that they will accept these aggressive alternatives, therefore future research should examine the difference between actual and intended negotiation outcomes.

One of the common criticisms to the use of simulated scenario is that participants will take into consideration accountability towards third parties even if these are not mentioned in the case scenario. Therefore, participants may respond according to what is expected from them and do not report the way they actually behave.

Another limitation in our study that needs to be considered is that the client's negotiation strategy was assumed to be constant i.e. contending position. Interpretations might be biased as auditors are likely to respond differently to cooperative clients (e.g.

those using conceding, compromising and integrative strategies) and therefore future research could manipulate client's negotiation strategy besides the other variables.

Furthermore, we only considered a single issue in our experiment, this can limit the observation of trading-off issues that auditors might use, Auditors often negotiate an agenda of issues at once; therefore, the accounting issue should include more accounting issues similar to what auditors normally bring to the negotiation table.

Also, this study assumed that auditors make judgement individually which is far from what is observed in the practice as auditors seek the assistance of consultation units within their firm when they resolve contentious accounting issues, especially when they are dealing with risky clients, therefore future research could investigate auditors negotiating as a team.

Our setting considered a single-period game, while auditor-client negotiations are actually multi-period game and negotiation may change over the negotiation process. Therefore, future research could consider a multi-period negotiation.

Another limitation is that our participants are professional students having accounting and auditing experience. Although students have been proved to be as good surrogates in auditing research, still it is the audit partners who are involved in the auditor-client negotiation process. In this line, Gibbins et al. (2005) reported that audit managers and partners have different negotiation outcomes and negotiation strategies. Therefore, it is expected that responses of our participants might be different to these of audit partners; future research could replicate this study with audit partners and compare it to the findings of the current study.

With the increasing use of the internet, some of the exchanges regarding the negotiation is done online; therefore, we believe that comparing the outcomes of face-to-face negotiation to “electronic” negotiation is a fruitful area for future work.

Future research is needed to further explore the interactions of engagement risk, client pressure and bargaining power and how they influence the negotiation outcomes and negotiation strategies.

9.7 Conclusion

This research responds to calls for negotiation research that studies the influence of engagement risk, as auditors are expected to adapt their judgement according to the riskiness of their situation (Brown and Johnstone, 2009). This research poses a few questions that warrant future research on the role of engagement risk in auditor-client disputes. Additional research could shed light on the somewhat surprising results related to engagement risk effect and future research is warranted to confirm the motivational reasoning hypothesis.

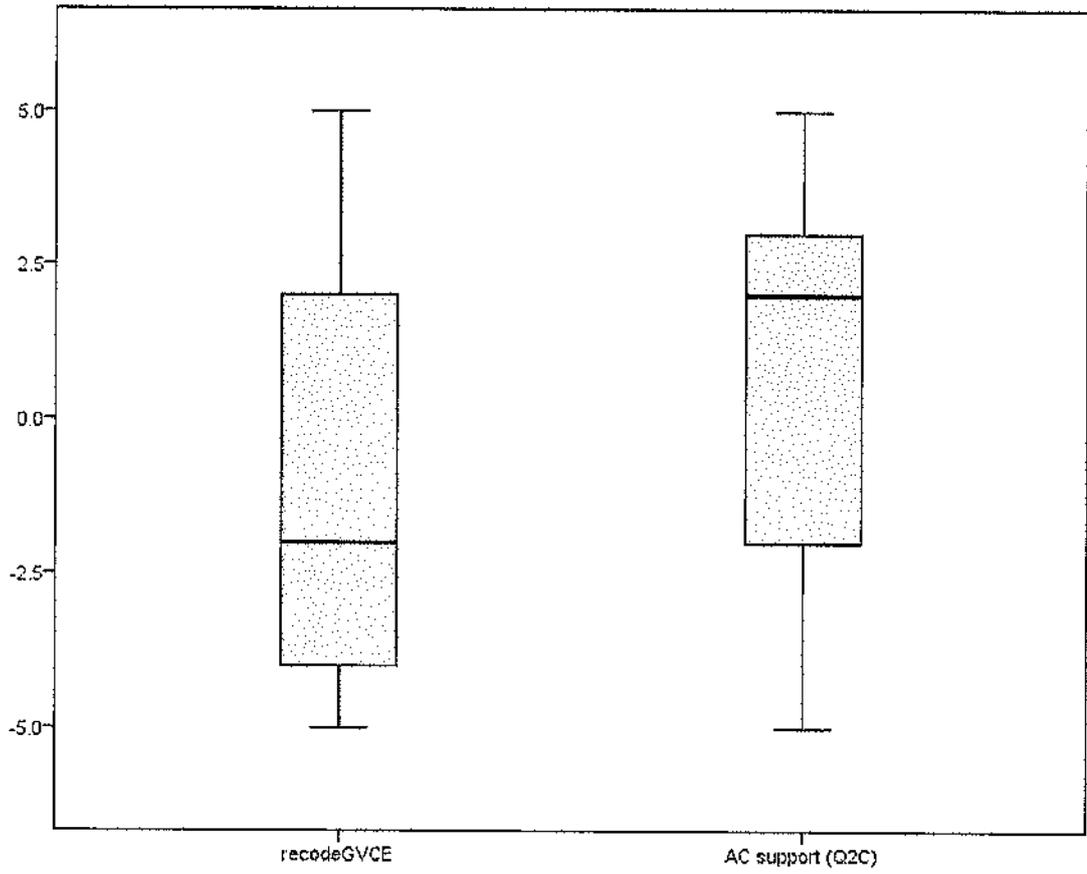
Findings highlight the role of the audit committee in improving the bargaining power of the auditor. The results particularly highlight the limitation of auditors who are more inclined to concede to the client management when they are dealing with a weak audit committee. Consequently, regulators and practitioners should look for other mechanisms that may counterbalance this weakness.

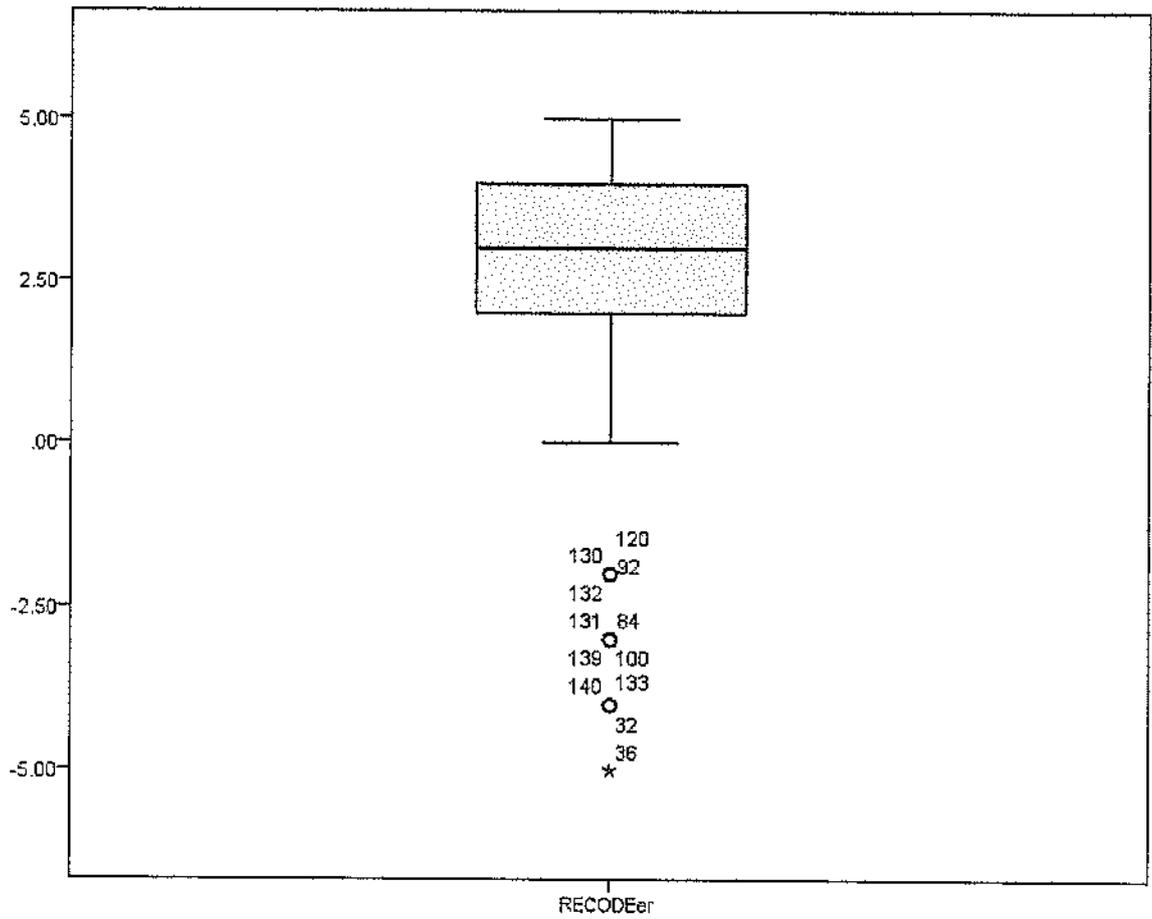
The current study provided evidence that client pressure has an impact only on auditor’s use of compromising strategy. This finding shows that SOX may be adequate, this is different to Moore et al. (2006)’s findings.

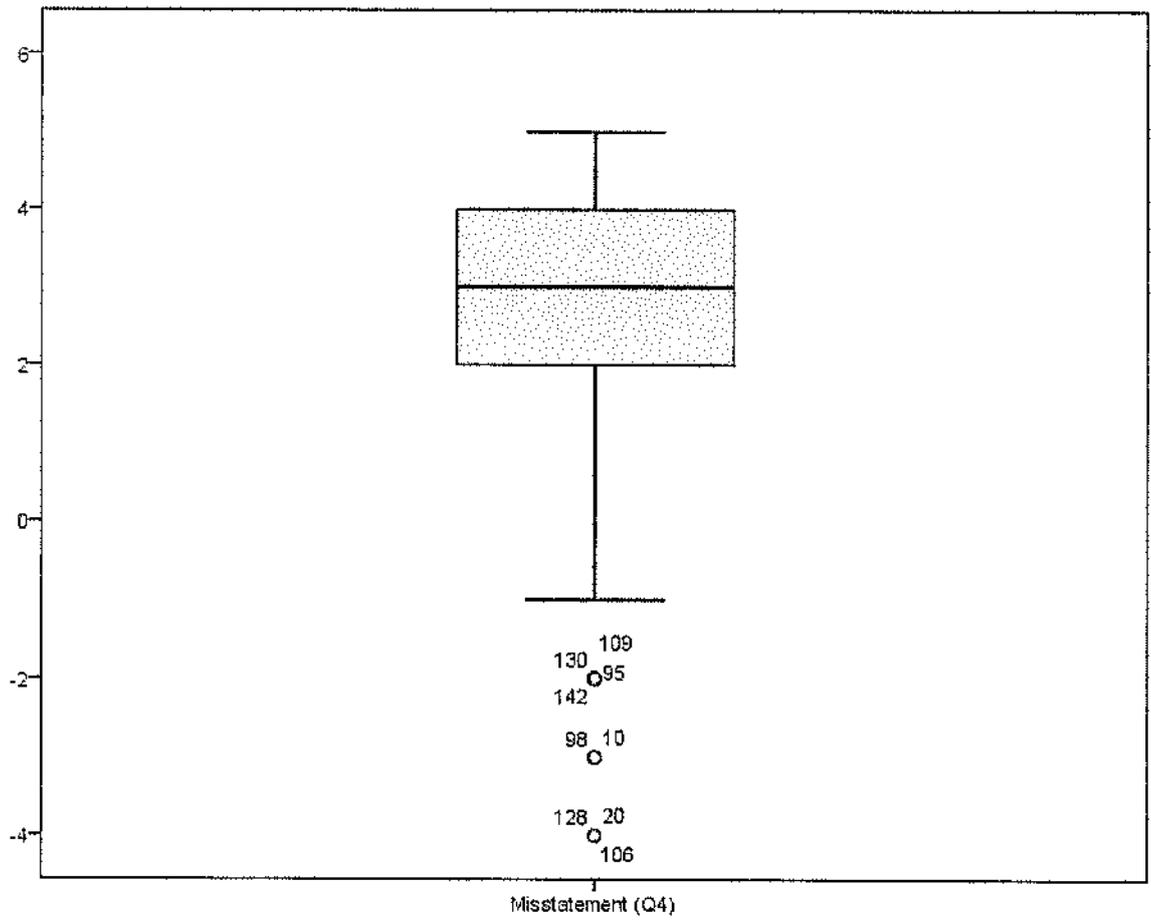
The findings related to the examination of the audit committee shows that audit committee strength and auditor's concession strategy use are negatively related. This suggests that a strong audit committee improves auditor's bargaining power. Thus, for those auditors who tend to side with the client's position, it appears that an efficient audit committee will counterbalance this behavior.

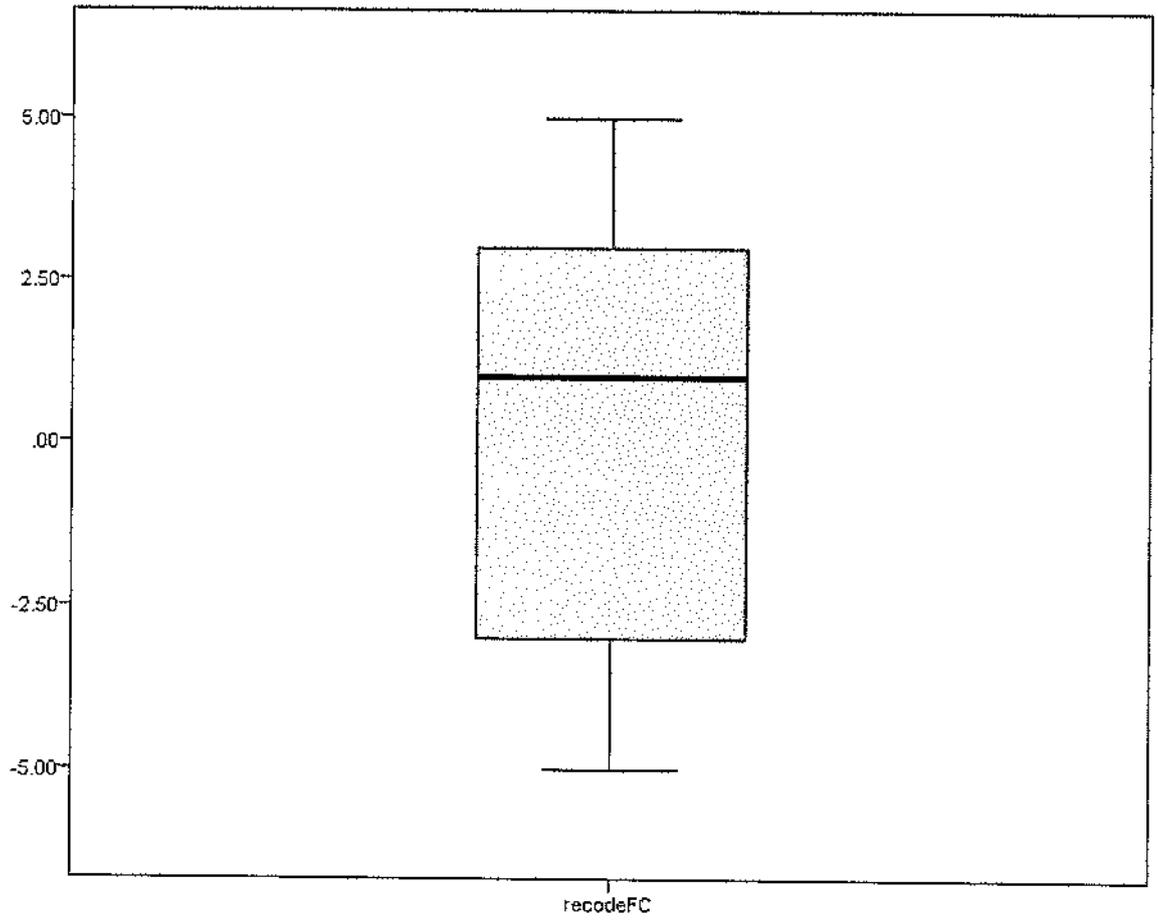
Appendices

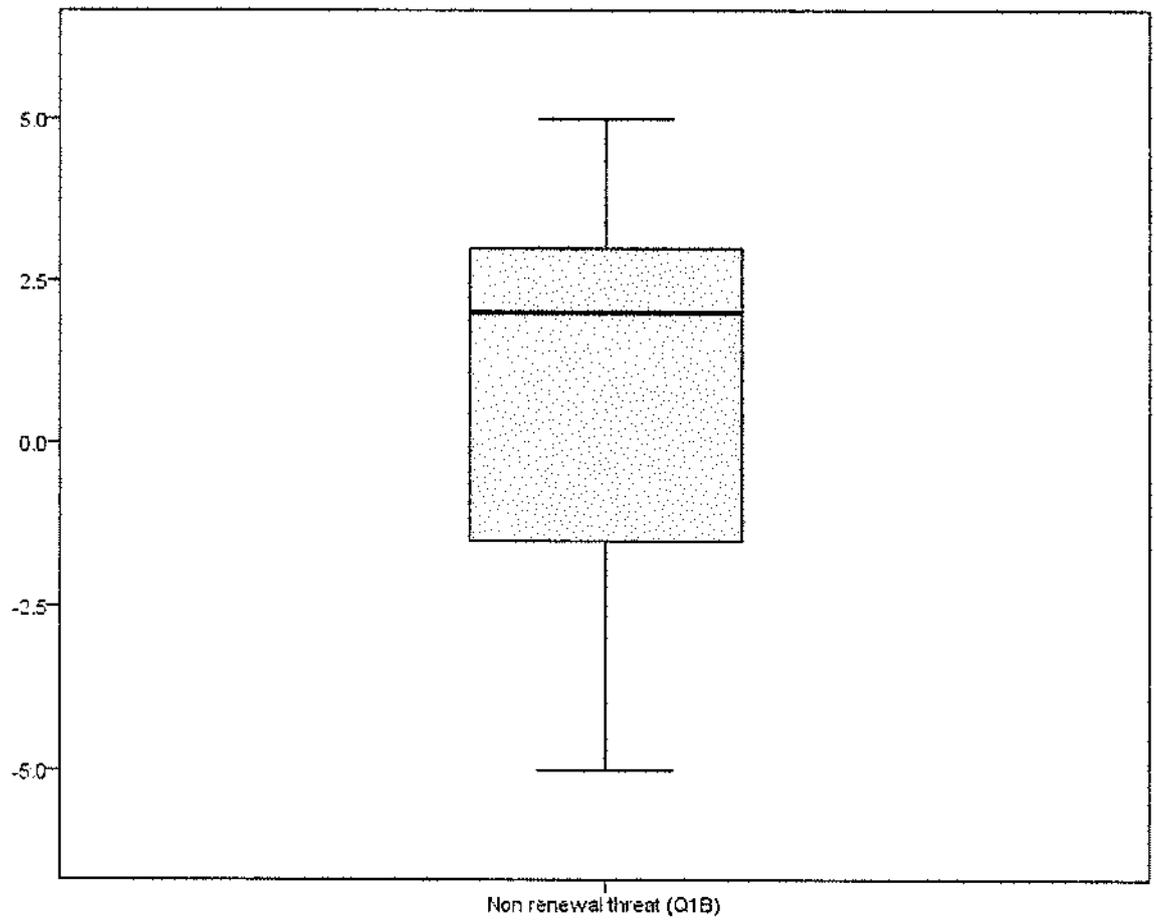
Appendix A: Boxplots

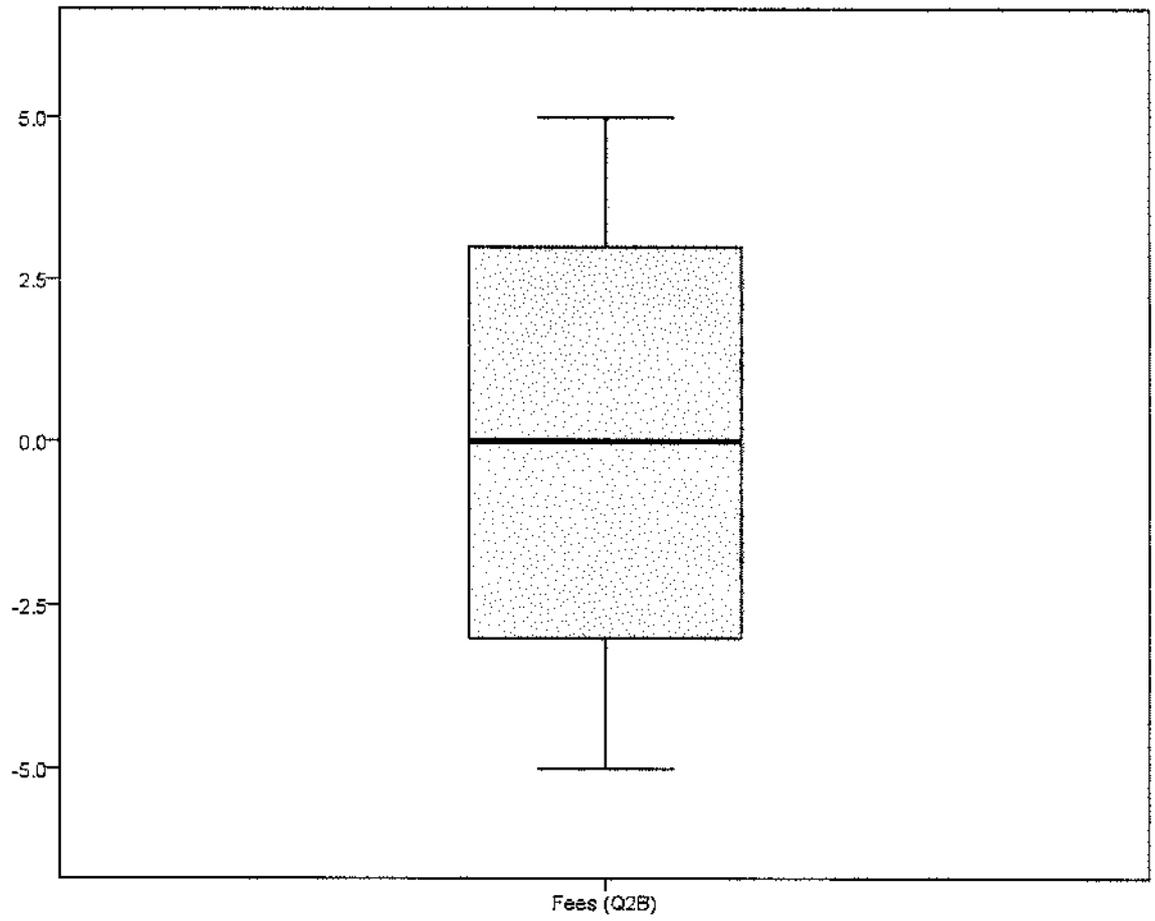


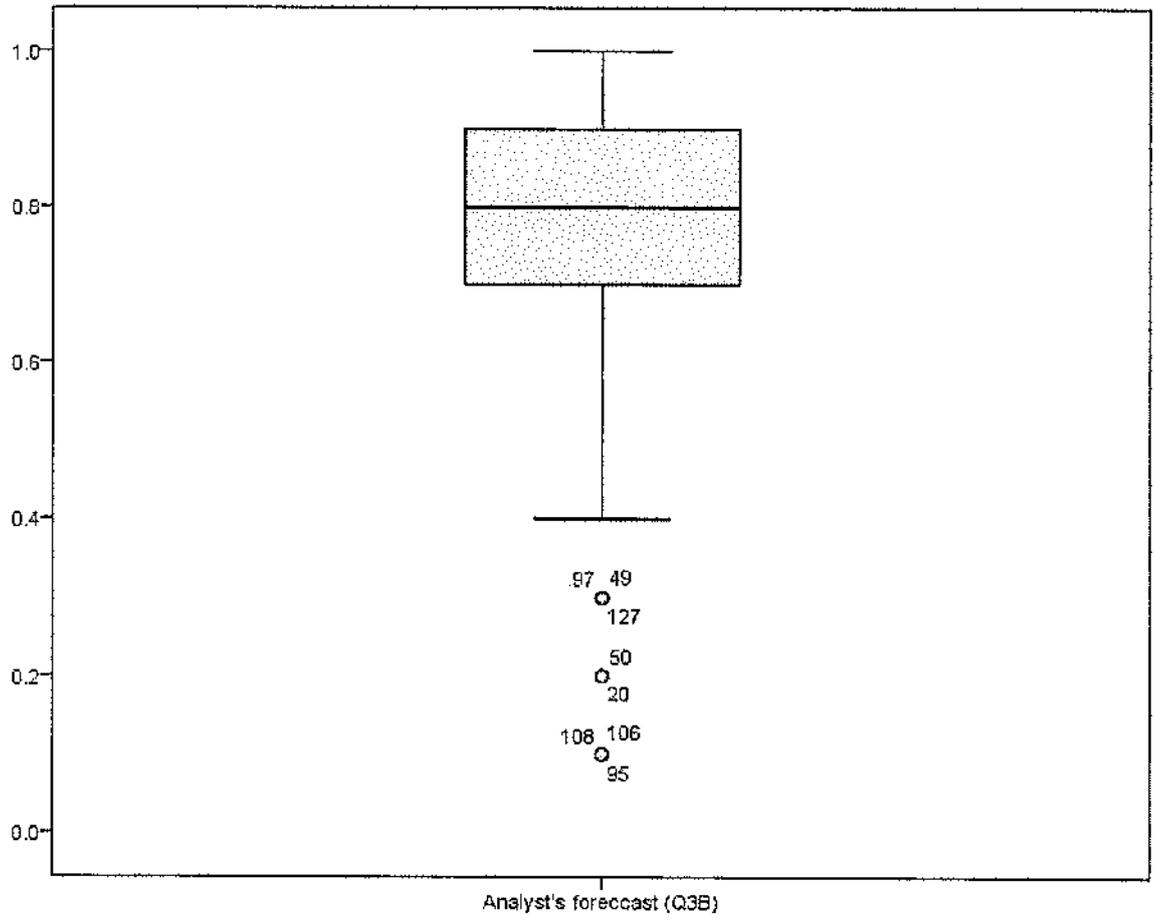


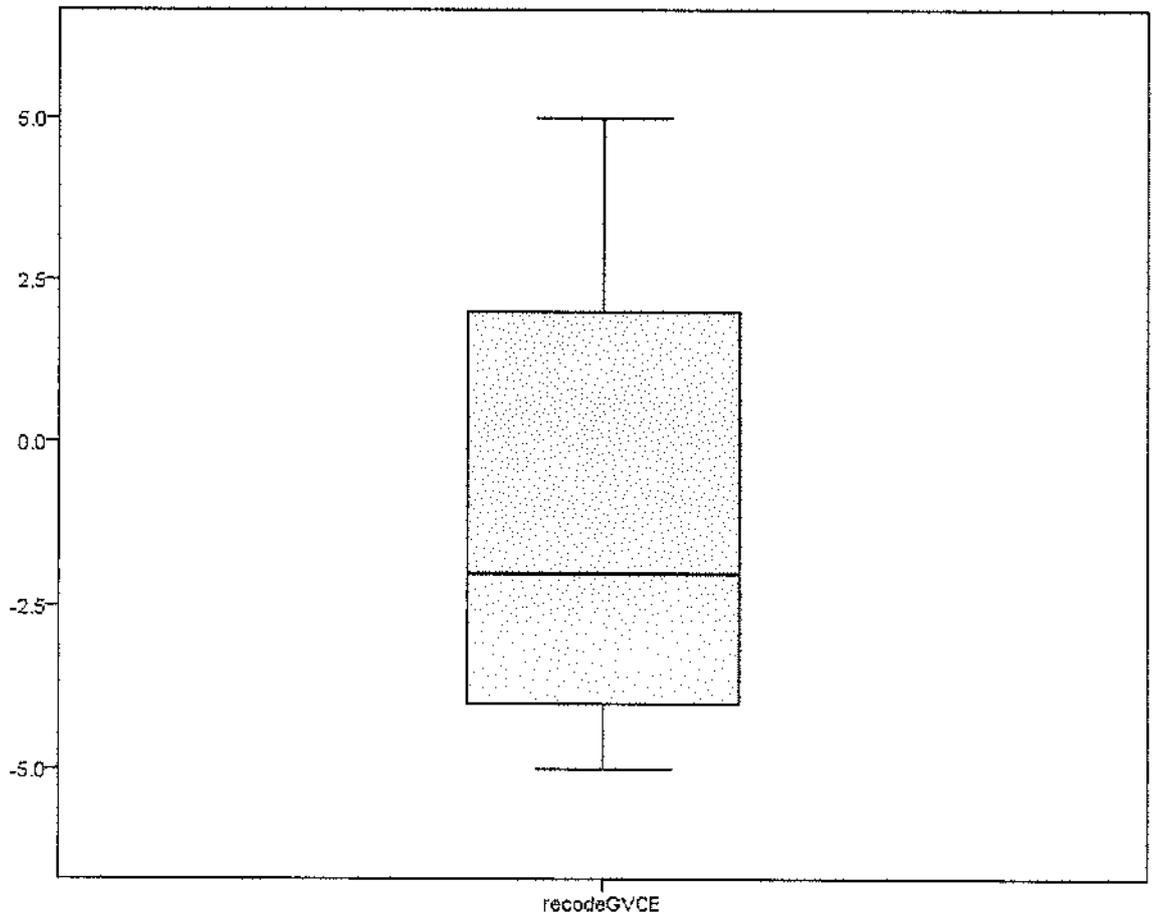


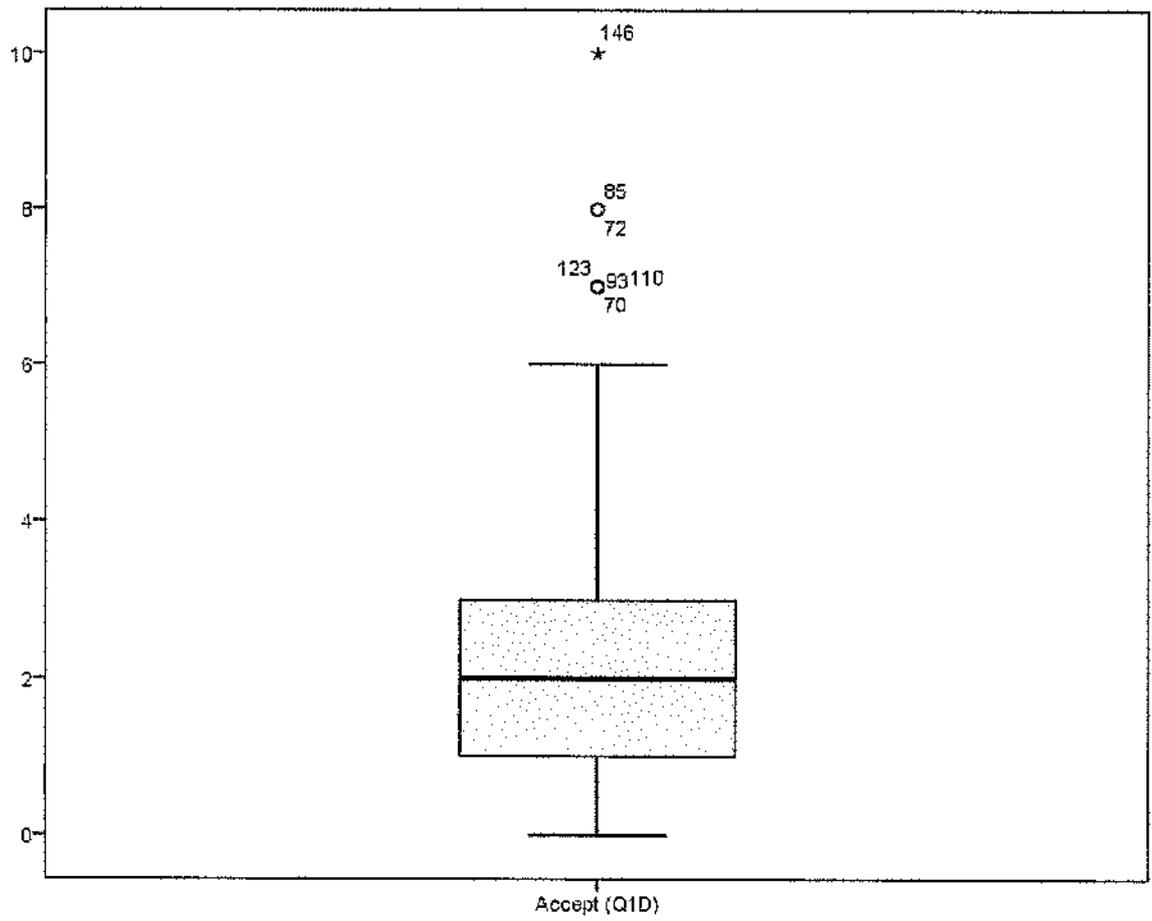


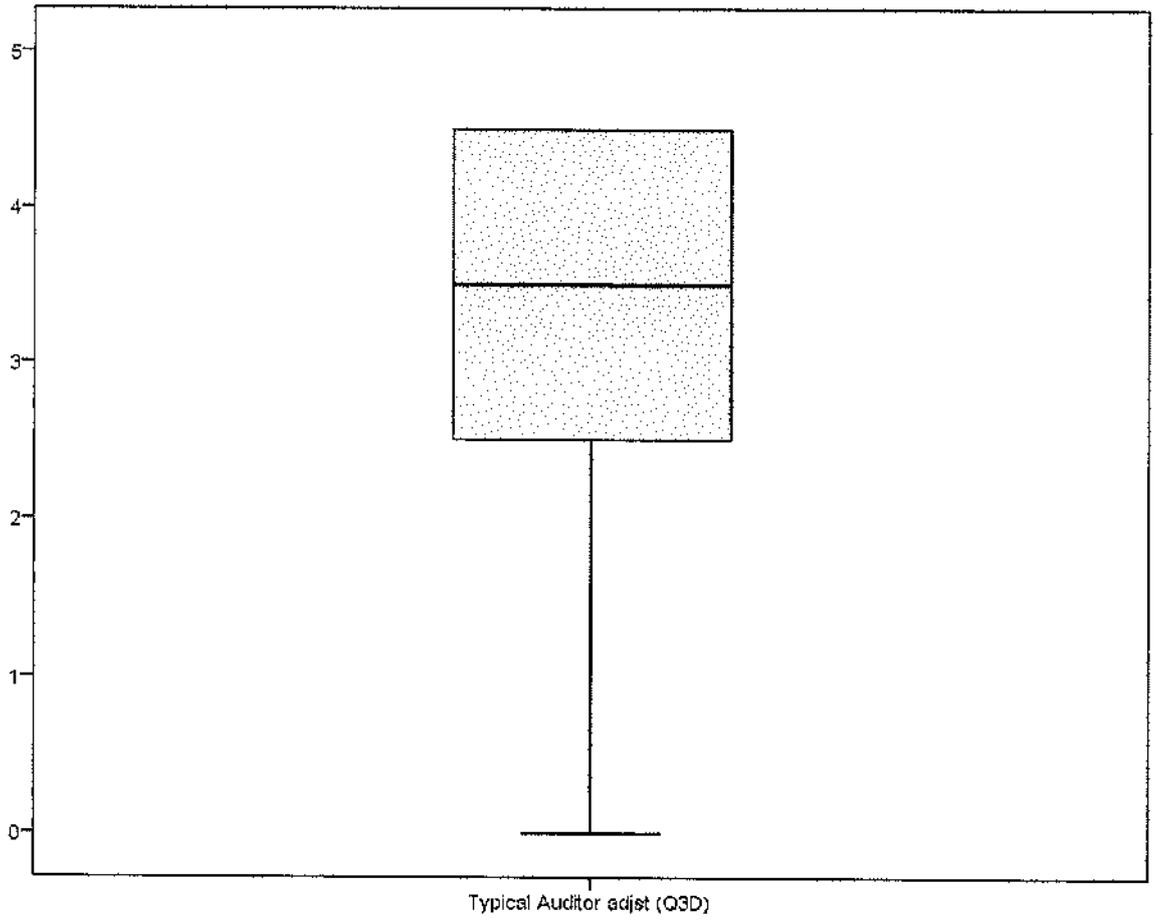


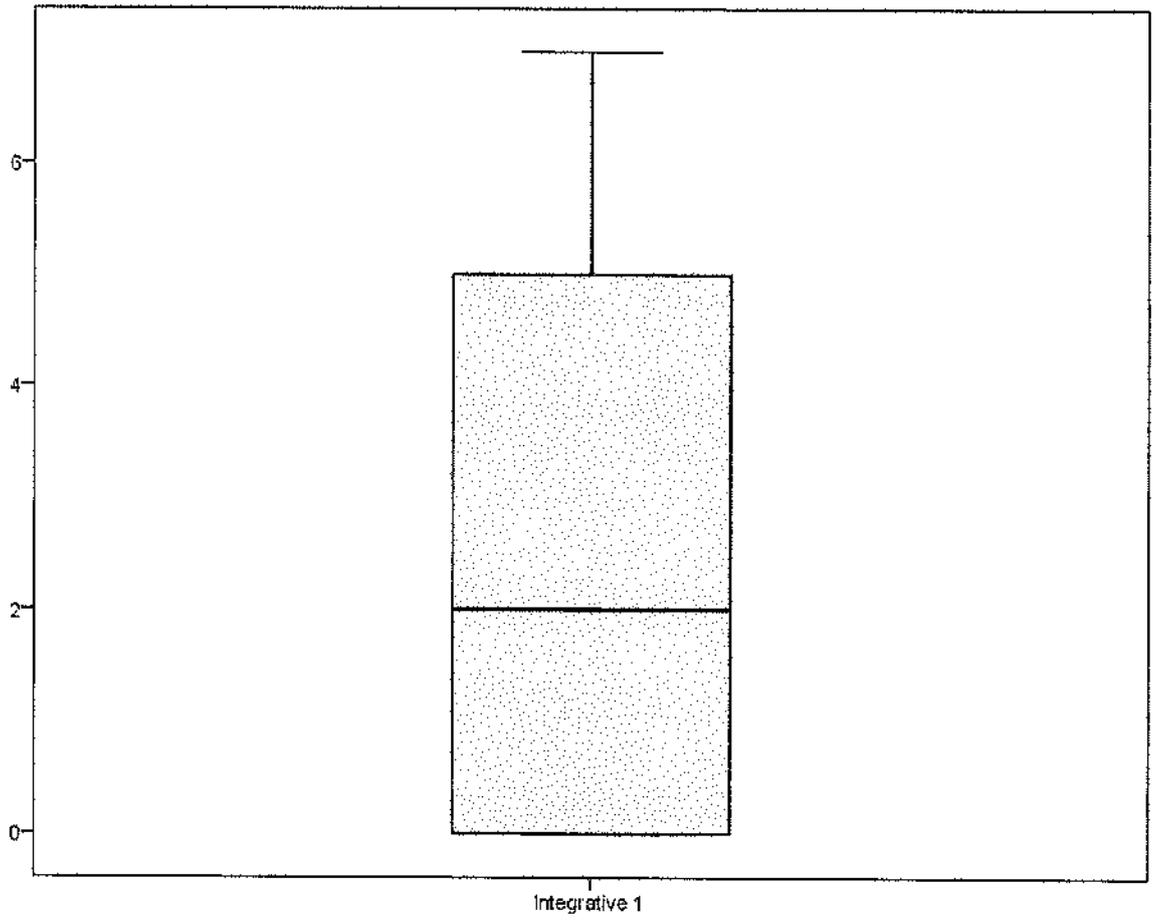


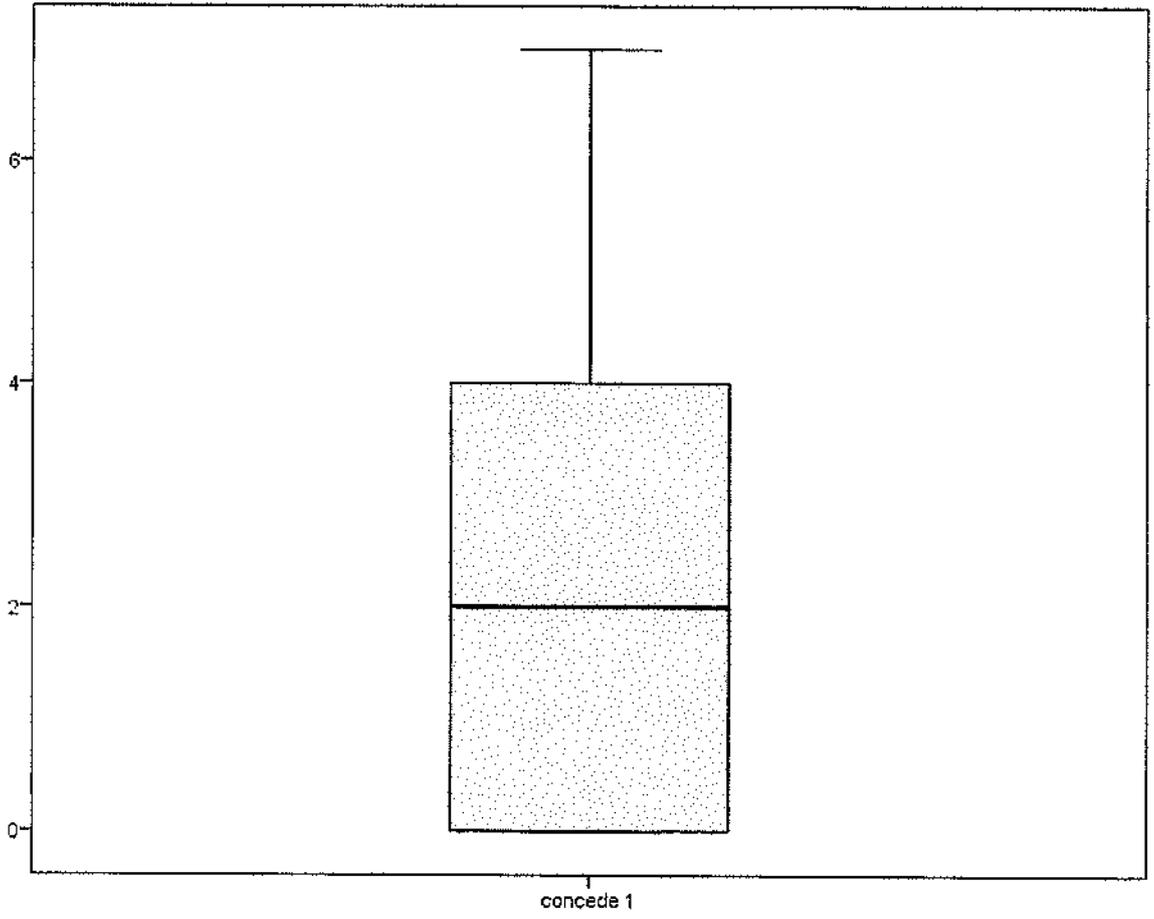


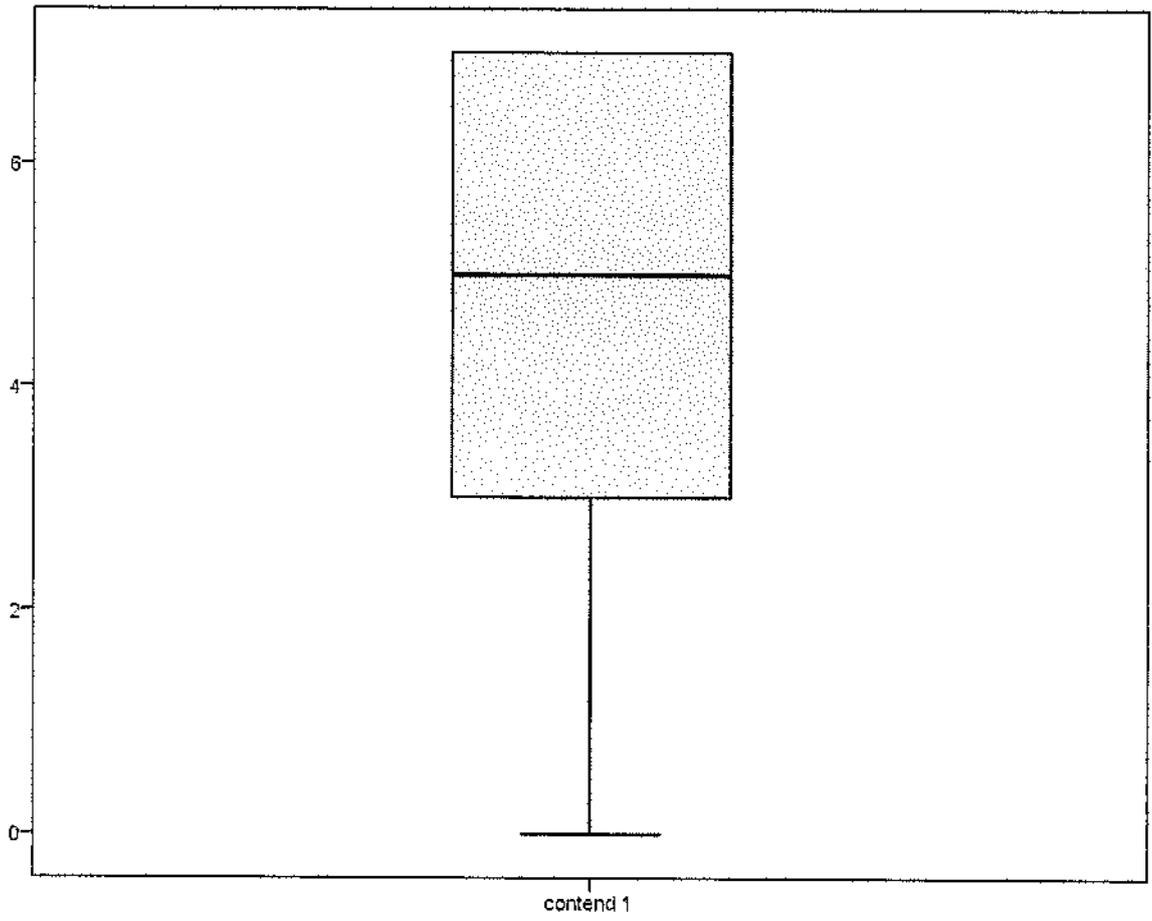


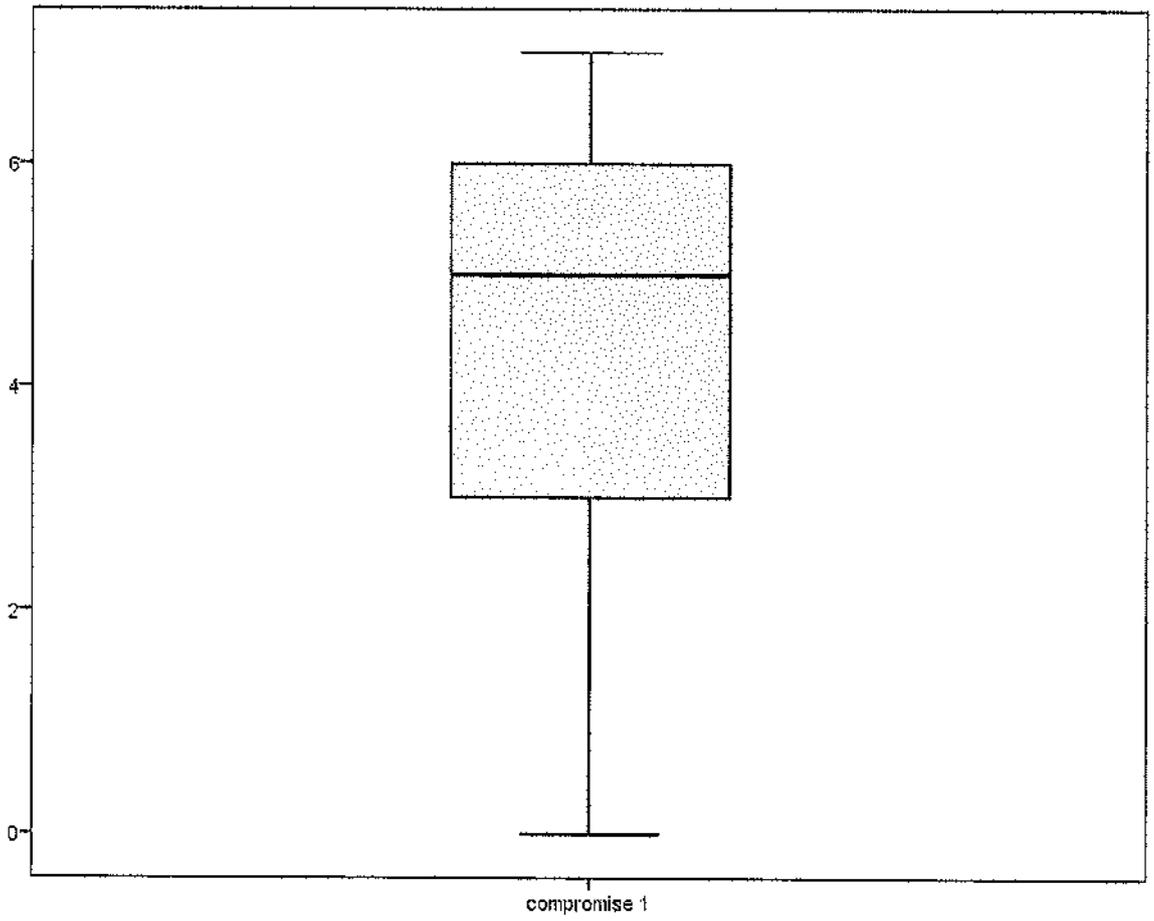


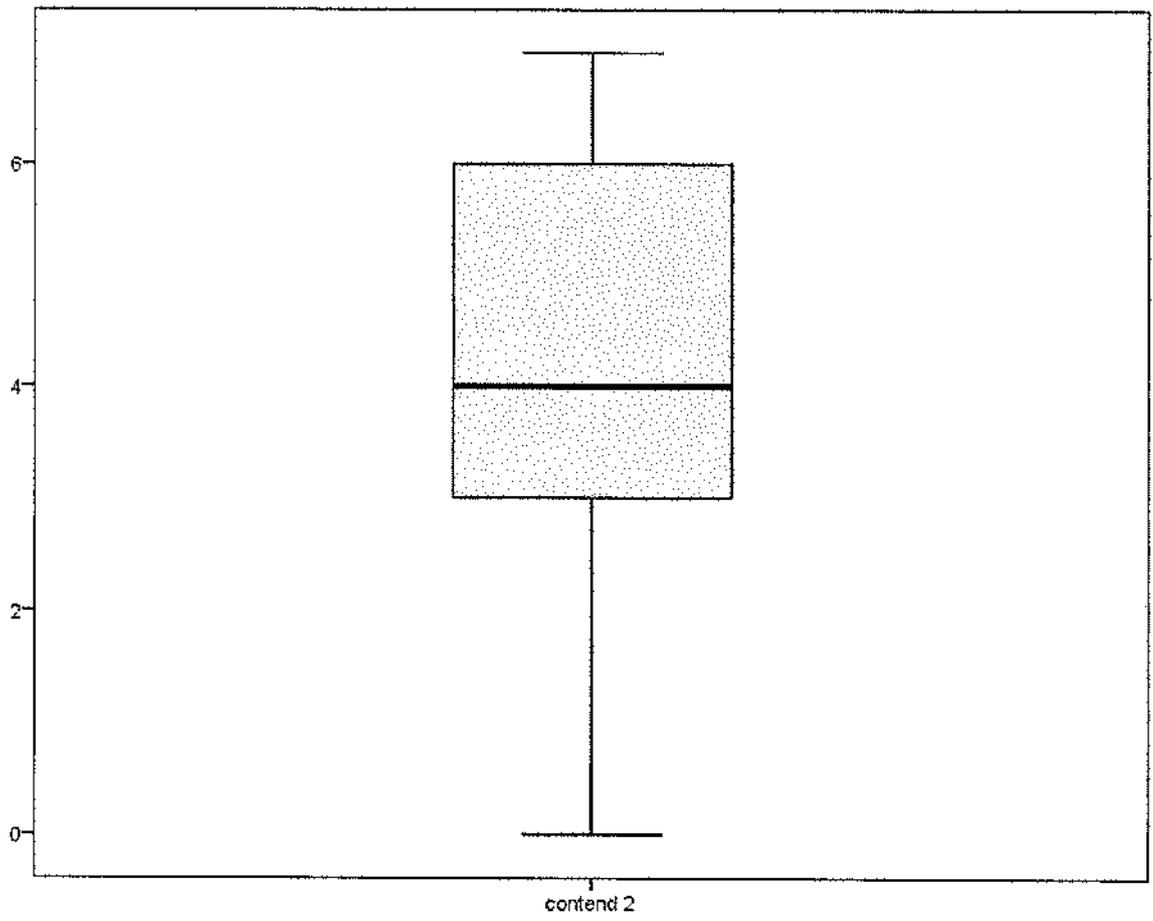


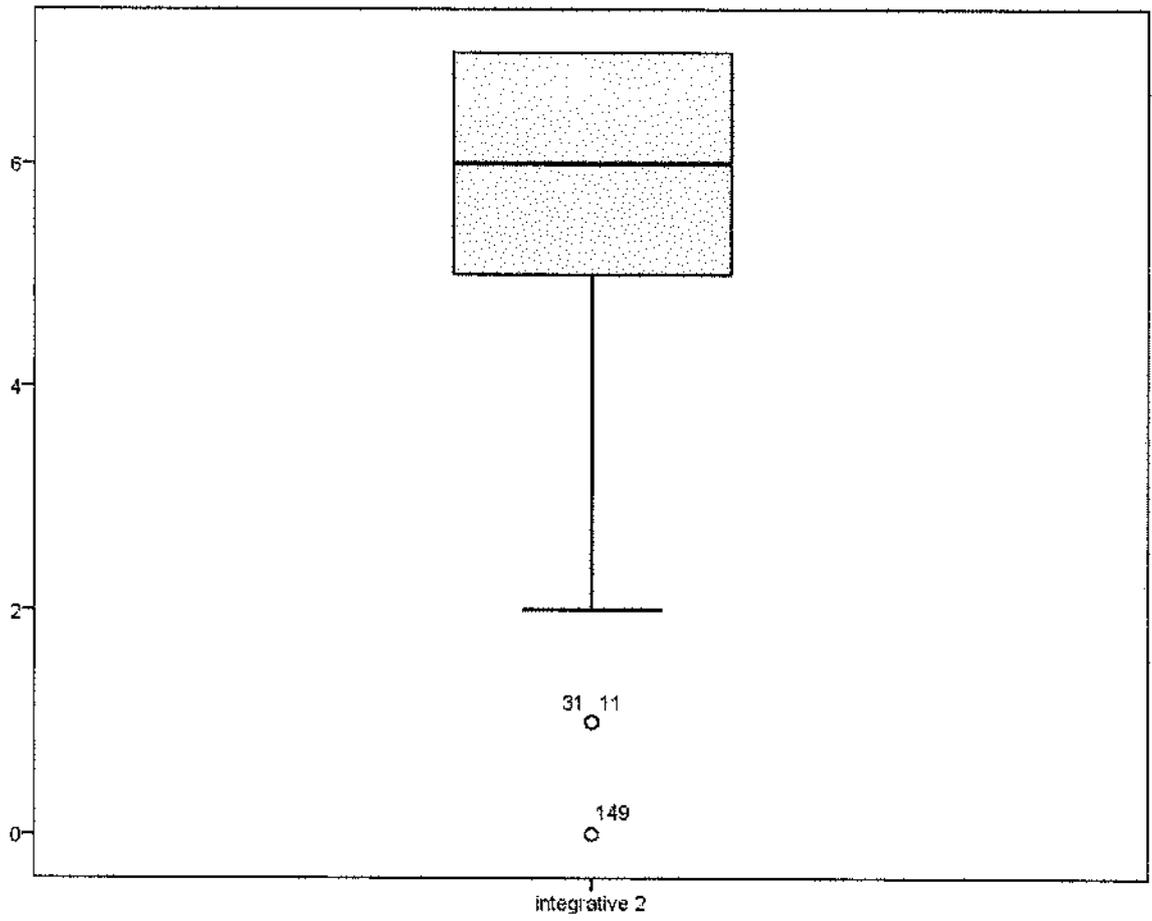


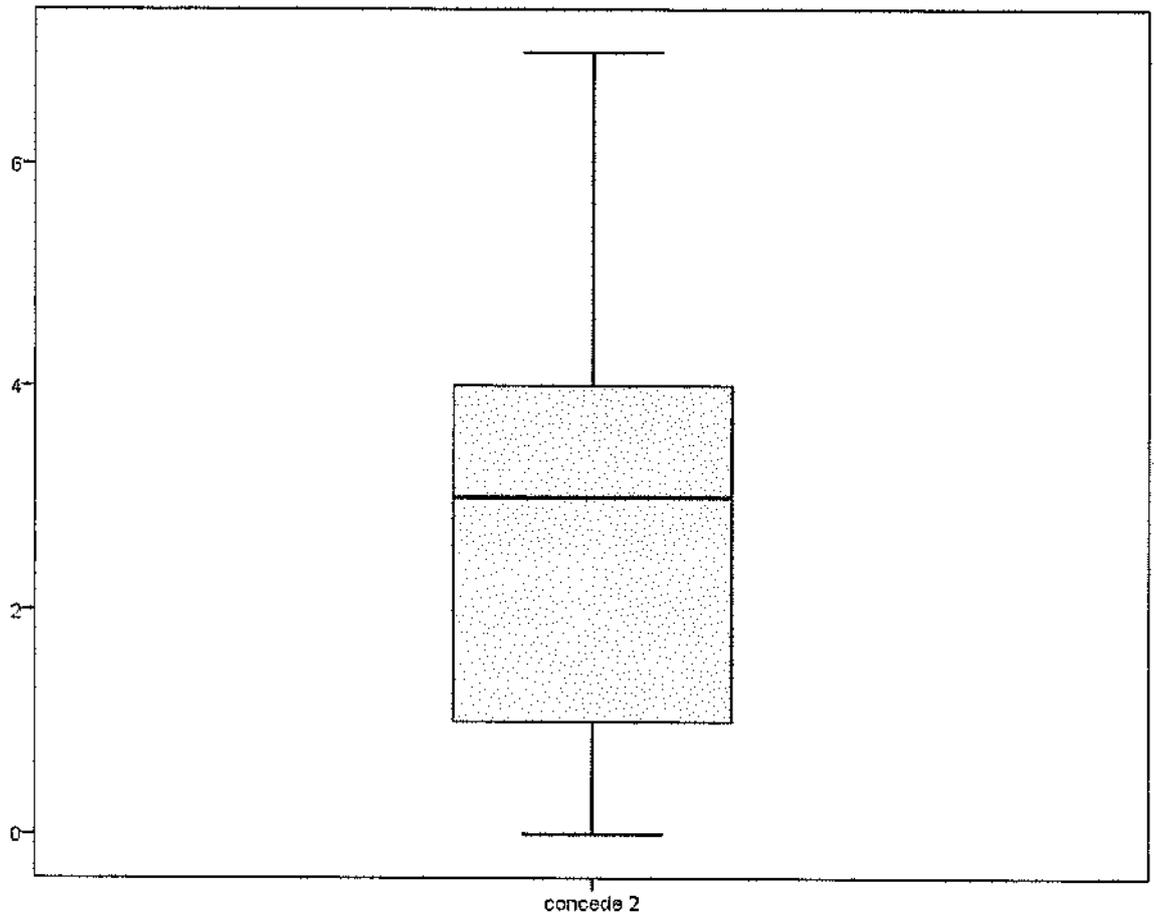


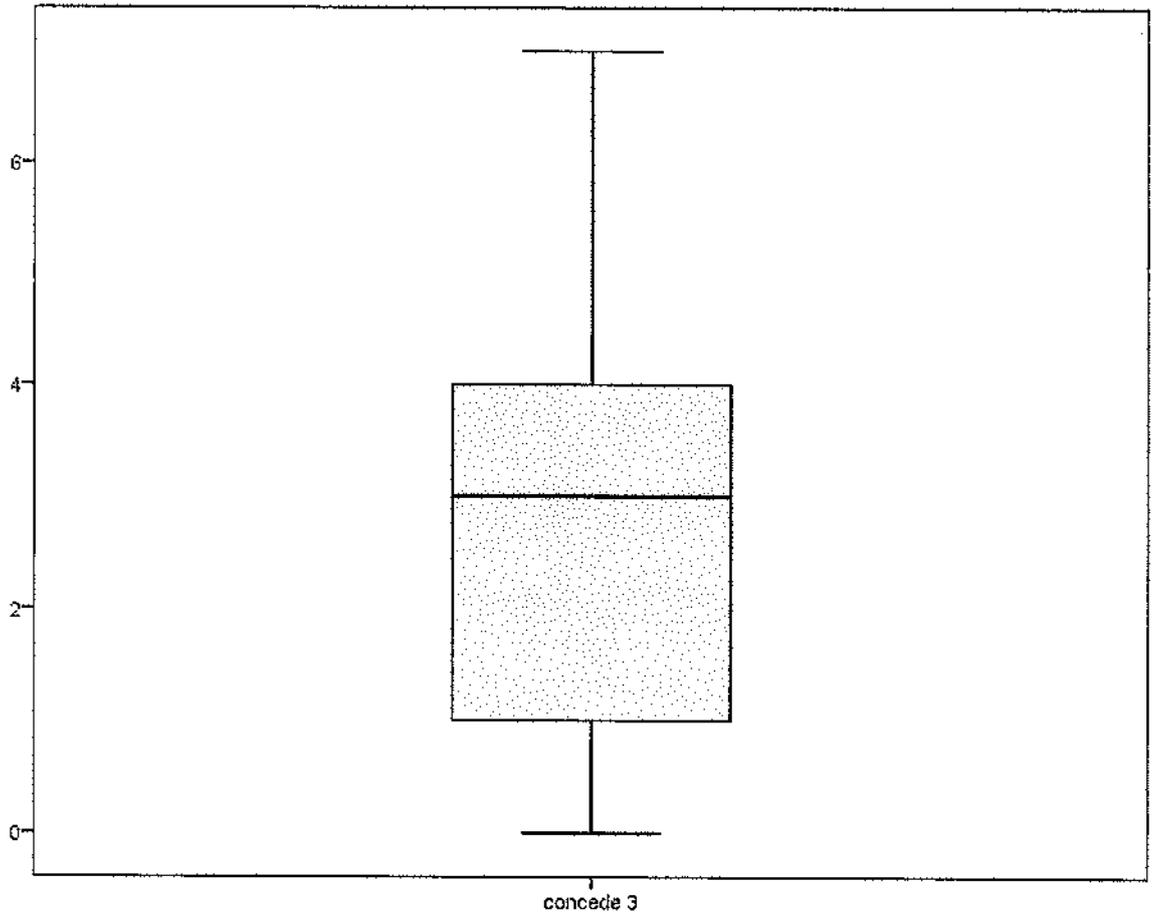












Appendix C: Research Ethic form

Business School

A PROFORMA FOR STAFF AND STUDENTS BEGINNING A RESEARCH PROJECT

This proforma should be completed by all staff and research students undertaking any research project and by taught students undertaking a research project as part of a taught module.

Part A (compulsory)

Research Proposer(s): Sarra Baroudi

Student number (if applicable): 201301491

University of Hull email address: s.baroudi@2013.hull.ac.uk

Programme of Study: PhD Accounting

Research (Working Dissertation/Thesis) Title: Auditor selection of negotiation strategies: The joint effect of motivational factor and bargaining power

Research (brief): Presenting a Throughput Model framework that describes decision making process of auditors through which perception of the engagement risk, client pressure and auditor client relationship are bundled by auditors when making decision about negotiation strategies.

Proforma Completion Date: 20/03/2015

Tick and sign by one of the following statements:

- 1) I confirm that *human participants are not involved in my research and in addition no other ethical considerations are envisaged.*

Signature of researcher.....

- 2) Human participants are involved in my research and/or there are other ethical considerations in my research.

Signature of researcher.....

If statement 1 is ticked and signed, there is no need to proceed further with this proforma, and research may proceed now.

If statement 2 is ticked and signed the researcher should complete part B of this proforma.

Part B

This proforma should be read in conjunction with the Ethical Principles for Researchers and the HUBS flow chart of **research** ethics procedures. It should be completed by the researchers. It should be sent on completion, together with a brief (maximum one page) summary of the issues/problems in the research (and how they are proposed to be dealt with), for approval to the Chair of the HUBS Research Ethics Committee (or nominated Committee member) or in the case of research being completed as part of a taught module to the student's supervisor or module leader prior to the beginning of any research.

NOTE

If this research has a research population of those under 18 years of age it requires specific authorisation, including that from authorities outside the University. It should not proceed until such authorisation has been obtained in writing.

1. Will you obtain written informed consent from the participants? Y/N
If yes, please include a copy of the information letter requesting consent. In the case of electronic surveys it is acceptable to advise participants that completion of the survey constitutes consent. Please provide a printout of the survey template.
If no, the research should not proceed unless you can specifically satisfy the Research Ethics Committee with the measures you will take to deal with this matter.

2. Has there been any withholding of disclosure of information regarding the research/teaching to the participants? Y/N
If yes, please describe the measures you have taken to deal with this.

3. Issues for participants. Please answer the following and state how you will manage perceived risks if any answer is YES:
 - a) Do any aspects of the study pose a possible risk to participants' physical well-being (e.g. use of substances such as alcohol or extreme situations such as sleep deprivation)? YES NO
 - b) Are there any aspects of the study that participants might find humiliating, embarrassing, ego-threatening, in conflict with their values, or be otherwise emotionally upsetting? YES NO
 - c) Are there any aspects of the study that might threaten participants' privacy (e.g. questions of a very personal nature; observation of individuals in situations which are not obviously 'public')? YES NO
 - d) Does the study require access to confidential sources of information (e.g. medical records)? YES NO
 - e) Could the intended participants for the study be expected to be more than usually emotionally vulnerable (e.g. medical patients, bereaved individuals)? YES NO
 - f) Will the study take place in a setting other than the University campus or residential buildings? YES NO

There is no potential risk

- g Will the intended participants of the study be individuals who are not members of the University community? YES NO

There is no potential risk

*Note: if the intended participants are of a different social, racial, cultural, age or sex group to the researcher(s) and there is any doubt about the possible impact of the planned procedures, then opinion should be sought from members of the relevant group.

4. Might conducting the study expose the researcher to any risks (e.g. collecting data in potentially dangerous environments)? Explain your method of dealing with this. YES NO
5. Is the research being conducted on a group culturally different from the researcher/student/supervisors? Y/N
If yes, are sensitivities and problems likely to arise? Y/N?
If yes, please describe how you have addressed/will address them.
6. Does the research conflict with any of the HUBS's research ethics principles? Y/N
If YES do not proceed Describe for the Research Ethics Committee what action you have taken to address this?
7. If the research requires the consent of any organisation, have you obtained it? Y/N
If NO do not proceed Describe for the Research Ethics Committee what action you have taken to overcome this problem.
8. Did you have to discuss the likelihood of ethical problems with this research with an informed colleague? Y/N
If yes, please name the colleague and provide the date and results of the discussion.

Thank you for completing this proforma. If you are a research student/member of staff this form must be signed by you, your supervisor/colleague and the HUBS Research Ethics Committee representative for your area. In the case of students undertaking research as part of a taught module, it must be signed by you and your supervisor or module leader. Once signed, staff and research students should send copies of this form, and the proposal must be sent to the Secretary of the Research Ethics Committee, Hull University Business School (see flow chart), including where possible examples of letters describing the purposes and implications of the research, and any Consent Forms (see appendices).

Name of Researcher/Student: Sarra Baroudi

Signature Date 13/03/2015

Name of Supervisor/Colleague/Module leader : Pr Waymond Rodgers

Signature Date

For proformas completed by staff and research students only:

Name of Research Ethics Committee member

Signature Date

For proformas relating to research funded by grants, please complete the following:

pFact no:

RAR no:

Funder/sponsor.....

Appendix D: Sample Consent Forms

Business School

RESEARCH ETHICS COMMITTEE

CONSENT FORM: SURVEYS, QUESTIONNAIRES

I, _____ of _____

Hereby agree to participate in this study to be undertaken

By Sarra Baroudi

and I understand that the purpose of the research is *(to be completed by the researcher)*

To study the auditor decision making process

I understand that

1. Upon receipt, my questionnaire will be coded and my name and address kept separately from it.
2. Any information that I provide will not be made public in any form that could reveal my identity to an outside party i.e. that I will remain fully anonymous.
3. Aggregated results will be used for research purposes and may be reported in scientific and academic journals (including online publications).
4. Individual results **will not** be released to any person except at my request and on my authorisation.

5. That I am free to withdraw my consent at any time during the study in which event my participation in the research study will immediately cease and any information obtained from me will not be used.

Signature:

Date:

The contact details of the researcher are:

Sarra Baroudi: s.baroudi@2013.hull.ac.uk

The contact details of the secretary to the HUBS Research Ethics Committee are Amy Cowling, Hull University Business School, University of Hull, Cottingham Road, Hull, HU6 7RX. Email: a.cowling@hull.ac.uk tel. 01482-463410.

In some cases, consent will need to be witnessed e.g. where the subject is blind/intellectually disabled. A witness must be independent of the project and may only sign a certification to the level of his/her involvement. A suggested format for witness certification is included with the sample consent forms. The form should also record the witnesses' signature, printed name and occupation. For particularly sensitive or exceptional research, further information can be obtained from the HUBS Research Ethics Committee Secretary, e.g., absence of parental consent, use of pseudonyms, etc)

NOTE:

In the event of a minor's consent, or person under legal liability, please complete the Research Ethics Committee's "Form of Consent on Behalf of a Minor or Dependent Person".

Appendix E: Research instrument: Manipulation and Variables measurement

“Creative Tech” is a leading designer and manufacturer of computer games. Consistent with the rest of the technology driven electronics industry, the computer game industry is characterized by frequent introduction of new products, short product-life cycles, competitive selling prices and evolving industry standards.

Appendix 1. (Perception + Information)

Engagement Risk Manipulation and Measurement of Perceived Engagement Risk.

The information is represented by key financial performance measures in the table

Panel A: Manipulation of Engagement Risk

High Engagement Risk Manipulation	Low Engagement Risk Manipulation																																																																																																
<p>In 2012, the company’s share of the UK market for computer games was 60% but by 2014 its market share had dropped to 28%. Additionally, the company’s most recent financial results are disappointing (Refer to table below).</p>	<p>In 2012, the company’s share of the UK market for computer games was 40% and by 2014 its market share had increased to 60%. Additionally the company’s most recent financial results are satisfactory (Refer to table below).</p>																																																																																																
<table border="1"> <thead> <tr> <th colspan="4">Financial Performance Measures</th> </tr> <tr> <th></th> <th>2014</th> <th>2013</th> <th>2012</th> </tr> </thead> <tbody> <tr> <td colspan="4">Profitability</td> </tr> <tr> <td>Net Margin</td> <td>0.05</td> <td>0.11</td> <td>0.25</td> </tr> <tr> <td>ROE</td> <td>0.04</td> <td>0.18</td> <td>0.22</td> </tr> <tr> <td colspan="4">Working Capital Management</td> </tr> <tr> <td>Current asset turnover</td> <td>0.3</td> <td>0.5</td> <td>0.4</td> </tr> <tr> <td>A/R turnover</td> <td>0.33</td> <td>0.42</td> <td>0.48</td> </tr> <tr> <td>Inventory turnover</td> <td>0.29</td> <td>0.54</td> <td>0.50</td> </tr> <tr> <td colspan="4">Liquidity Risk</td> </tr> <tr> <td>Current ratio</td> <td>0.25</td> <td>0.50</td> <td>0.30</td> </tr> <tr> <td>Quick ratio</td> <td>0.70</td> <td>0.68</td> <td>0.75</td> </tr> </tbody> </table>	Financial Performance Measures					2014	2013	2012	Profitability				Net Margin	0.05	0.11	0.25	ROE	0.04	0.18	0.22	Working Capital Management				Current asset turnover	0.3	0.5	0.4	A/R turnover	0.33	0.42	0.48	Inventory turnover	0.29	0.54	0.50	Liquidity Risk				Current ratio	0.25	0.50	0.30	Quick ratio	0.70	0.68	0.75	<table border="1"> <thead> <tr> <th colspan="4">Financial Performance Measures</th> </tr> <tr> <th></th> <th>2014</th> <th>2013</th> <th>2012</th> </tr> </thead> <tbody> <tr> <td colspan="4">Profitability</td> </tr> <tr> <td>Gross Margin</td> <td>0.78</td> <td>0.69</td> <td>0.53</td> </tr> <tr> <td>ROE</td> <td>1.8</td> <td>1.4</td> <td>1.6</td> </tr> <tr> <td colspan="4">Working Capital Management</td> </tr> <tr> <td>Current asset turnover</td> <td>2.48</td> <td>2.36</td> <td>1.38</td> </tr> <tr> <td>A/R turnover</td> <td>5.03</td> <td>4.40</td> <td>4.35</td> </tr> <tr> <td>Inventory turnover</td> <td>5.00</td> <td>4.53</td> <td>4.63</td> </tr> <tr> <td colspan="4">Liquidity Risk</td> </tr> <tr> <td>Current ratio</td> <td>3.55</td> <td>3.20</td> <td>2.80</td> </tr> <tr> <td>Quick ratio</td> <td>4.02</td> <td>3.77</td> <td>3.10</td> </tr> </tbody> </table>	Financial Performance Measures					2014	2013	2012	Profitability				Gross Margin	0.78	0.69	0.53	ROE	1.8	1.4	1.6	Working Capital Management				Current asset turnover	2.48	2.36	1.38	A/R turnover	5.03	4.40	4.35	Inventory turnover	5.00	4.53	4.63	Liquidity Risk				Current ratio	3.55	3.20	2.80	Quick ratio	4.02	3.77	3.10
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<p>Anxious to regain market share and compete with much larger companies (Microsoft, Logitech and Trust master), “Creative Tech” invested shares on the public stock market to infuse needed capital.</p> <p>In response to these financial pressures, “Creative Tech” had adopted a new remuneration strategy, in order to enhance</p>	<p>The company was founded by its current chairman. Following expansion into overseas market, it was floated to permit more capital to be raised, although control remains with the chairman’s family.</p> <p>The remuneration is based on management bonuses which were tied to sales target and “Creative Tech” group had met its sales target.</p>																																																																																																

its sales, management bonuses are now tied to sales which are not met.	
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Panel B: Measurement of Perceived Engagement Risk

The following are the five measures of perceived Engagement Risk

1-The term engagement risk refers to an audit firm's exposure to loss or injury to his or her professional practice from litigation, adverse publicity or other events arising in connection with financial statements audited or reported on.

Based on the information presented in this case, how would you assess engagement risk?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very High					Neither low nor high					Very low

2- What is the likelihood that litigation might be brought against your firm as the auditor of the company (assuming firm status)?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very little					Neither little nor large					Very large

3- What is the likelihood that you and your company reputation will be affected by auditing this company?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very little					Neither little nor large					Very large

4- What is your assessment of the likelihood that the company's management might have manipulated their accounts (assuming the remuneration strategy?)

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very little					Neither little nor large					Very large

5- What is your assessment of the company's financial condition?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Poor					Neither poor nor Good					Very good

Appendix 2. Client Pressure Manipulation and Measurement of Perceived Client Pressure (Perception + Information)

Panel A: Manipulation of Client Pressure

The information is represented by the analyst forecast

High client pressure	Low client pressure
<p>The company is one of your firm's largest clients based on the amount of billable hours that are generated from audit and tax services. Approximately 25% of your time will be dedicated to serving this client in 2015 and future years, and "Creative Tech" is soliciting bids for next year.</p> <p>The analyst forecasted EPS was \$1.11 resulting in a missed forecast if the auditor required the client to record the proposed adjusting entries.</p>	<p>The company is one of your firm's smallest clients based on the amount of billable hours that are generated from audit and tax services. Approximately 2 percent of your time will be dedicated to serving this client in 2015; you will remain the auditing firm for next year, since the company is not soliciting bids for next year.</p> <p>The analyst forecasted EPS was \$1.45, allowing the client to record the proposed adjusting up to £5 million journal entries and still hit the targeted EPS.</p>

Panel B: Measurement of Perceived client pressure

1-Given your knowledge of the client so far, to what extent do you perceive a threat of non-renewal of the audit engagement?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very Weak					Neither weak nor strong					Very Strong

2- To what extent do you perceive that your fees will be affected by losing this client?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Very Low					Neither low nor high					Very high

3- To what extent did you perceive that recording the adjustment precipitates the client missing of analyst forecast?

-5	-4	-3	-2	-1	0	1	2	3	4	5
0%					50%					100%

Appendix 3: Bargaining Power manipulation and perceived Bargaining power measurement

Panel A: Bargaining Power manipulation

Low Bargaining Power	High Bargaining Power
<p>In your past dealings with the Audit Committee, you have found that it has tendency to be sympathetic toward the management's position.</p> <p>Creative Tech's board of directors is composed of nine members; six are executive directors (including the chairperson) and three are non-executive directors. The audit committee is composed of three non-executives directors. One of the members is a CPA and has five years of experience in public accounting. The other two members are financially illiterate. Your experience with the audit committee is that they ask very few questions and meet two times a year. Finally, the board has granted the audit committee limited power in executing its authority, and very rarely will the board side with the audit committee on contentious issues involving management.</p>	<p>In your past dealings with the Audit Committee, you have found that it consistently exercises independent judgment without a tendency to be sympathetic toward the management's position.</p> <p>Creative Tech has a board of directors of nine members, three are executives directors (including the chairperson) and six are non-executive directors. The audit committee is composed of three individuals, who are all independent. Two of the members have extensive experience in public accounting and the third member is financially literate. You have been very impressed with the audit committee's high level of diligence in representing shareholders' interests. They ask many probing questions and meet very frequently. Finally, the board has granted the audit committee a high level of power in executing its authority and almost always sides with the audit committee on contentious issues involving management.</p>

Panel B: Measurement of Perceived Bargaining power

1- How would you characterize "Creative Tech" governance mechanisms

-5	-4	-3	-2	-1	0	1	2	3	4	5
Strong					medium					Weak

2-Do you believe that you will receive support from the audit company in conflicting situations?

-5	-4	-3	-2	-1	0	1	2	3	4	5
Strongly disagree					Neither disagree nor agree					Strongly agree

Appendix 3: Judgment: what amount of audit adjustments they and a typical auditor would insist on?

Panel A: Management's aggressive accounting policy rejection judgment

1-How likely are you as an auditor of audit "Creative Tech" to accept the management's alternative and, therefore require no material adjustments to the financial statements.

0	1	2	3	4	5	6	7	8	9	10
Never					Somewhat					Definitely

Panel B. The auditor's required adjustment to bring the financial statements in conformance to GAAP

- 1- According to the audit evidence, there are \$4.5 million in potential additional adjustments that "Creative Tech" has not recorded yet. On which amount of adjustments would you as an auditor insist? ("m" = "millions")

0m	0.5m	1m	1.5m	2m	2.5m	3m	3.5m	4m	4.5m
----	------	----	------	----	------	----	------	----	------

- 2- On which minimum amount of adjustments would a typical auditor of "Creative Tech" insist in the described situation?

0m	0.5m	1m	1.5m	2m	2.5m	3m	3.5m	4m	4.5m
----	------	----	------	----	------	----	------	----	------

Appendix 5:

Panel C. Auditor's Intended Negotiation strategies

The following 9 items are employed to elicit the auditors' intended negotiation strategies. These strategies are an abbreviated version (9 items) of the 25 item measure in Gibbins et al (2010) that was drawn from Rahim (1983). The variable names (in brackets below) are not part of the instrument the auditors saw.

- 1- I would bring other issues to the discussion, such that I could trade- off on other issues to resolve this issue in my favour (integrative)
- 2- I would try to satisfy the expectations of the management (concede)
- 3- I would argue with the management to show them the merits of my position (contend)
- 4- I would try to find some middle ground to resolve this issue with the management (compromise)
- 5- I would use my influence to get my position accepted by the management (contend)
- 6- I would use my expertise in accounting to influence the resolution in my favour (contend)
- 7- I would try to work with the management to find new solutions to this issue that satisfy both of our expectations (Integrative)
- 8- I would try to satisfy the needs of the management (concede)
- 9- I would make concessions from my position to the management (concede)

Please indicate your likelihood of using each of the tactics below in order to resolve the issue?

Very
unlikely to
use

Very
likely
to use

0	1	2	3	4	5	6	7
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