Journal of International Accounting, Auditing and Taxation 24 (2015) 105–117

Contents lists available at ScienceDirect

Journal of International Accounting, Auditing and Taxation

Can expertise mitigate auditors' unintentional biases?

Andres Guiral[a,e], Waymond Rodgers[b,c], Emiliano Ruiz[d], Jose A. Gonzalo-Angulo[e,*]

[a] Yonsei University, Seoul, South Korea
[b] University of Hull, Hull, UK
[c] University of Texas, El Paso, TX, USA
[d] University of Cádiz, Cádiz, Spain
[e] University of Alcalá, Madrid, Spain

A R T I C L E   I N F O

Article history:
Available online 6 March 2015

Keywords:
Auditing
Conflicts of interest
Unintentional bias
Expertise
Self-fulfilling prophecy effect
Moral seduction theory

A B S T R A C T

It is important for both academics and practitioners to understand how biases influence auditing opinions, as well as how we might counteract those biases. According to moral seduction theory, auditors' judgments are morally induced by conflicts of interest in an unconscious manner. We combined an auditor ethical decision-making model with an expertise model in a laboratory experiment with European auditors to demonstrate that expertise helps to mitigate unconscious reporting bias in the going-concern setting. Our findings suggest that while problem-solving ability reinforces the auditors' public watchdog function, task-specific experience reduces their fear of provoking the self-fulfilling prophecy effect. Our contribution to the literature is timely since the European Green Paper on Auditing is ignoring auditor education, learning, and training as potentially effective ways to enhance audit quality and increase professional skepticism.

Introduction

In every audit, auditors have the responsibility to evaluate the ability of their clients to continue in existence. If doubts exist, they should release a "going-concern" opinion alerting investors and other stakeholders of clients' risk of bankruptcy (Citron & Taffler, 2001). This "public watchdog" function is extremely important since the issuance of a warning signal could significantly affect investors and other third parties' investments decisions. Making a going-concern judgment is generally viewed as one of the most complex tasks in auditing (Carson, Fargher, Geiger, Lennox, & Willekens, 2013; Chow, McNamee, & Plumlee, 1987; Guiral & Esteo, 2006; Rodgers, Guiral, & Gonzalo, 2009).

The "public watchdog" function demands that auditors maintain total independence from the client at all times and requires their complete fidelity to the public trust. However, the professional obligation of auditors often competes with their self-interest since they are hired and fired by their own clients (Bazerman, Morgan, & Loewenstein, 1997). One of the most important conflicts of interest is the so-called "self-fulfilling prophecy effect," which may bias auditors' reporting behavior. This effect is the fear that the issuance of a warning signal may precipitate client's failure because of its negative impact on current and potential investors, creditors, suppliers, and customers (Louwers, Messina, & Richard, 1999).

* Corresponding author. Tel.: +34 609404712; fax: +34 918854293.
E-mail addresses: andres.guiral@uah.es (A. Guiral), w.rodgers@hull.ac.uk, waymond.rodgers@ucr.edu (W. Rodgers), emiliano.ruiz@uca.es (E. Ruiz), josea.gonzalo@uah.es (J.A. Gonzalo-Angulo).

http://dx.doi.org/10.1016/j.intaccaudtax.2014.11.002
1061-9518/

Therefore, the self-fulfilling prophecy effect may lead auditors' self-interest to supersede the public interest since the fear of being dismissed after the release of that warning signal may be present (Citron & Taffler, 2001; Guiral, Ruiz, & Rodgers, 2011).

Moral seduction theory suggests that judgment bias operates at a subconscious level and that the cause of auditors' failure should be interpreted as an unconscious rather than a deliberate bias (Bazerman et al., 1997; Moore, Tetlock, Tanlu, & Bazerman, 2006; Moore, Tanlu, & Bazerman, 2010). In a recent experimental study, Guiral, Rodgers, Ruiz, and Gonzalo (2010) connected an ethical model to the moral seduction theory and demonstrated that auditors' judgments unconsciously may be induced by the self-fulfilling prophecy effect that, in turn, may help explain auditors' reluctance to issue going-concern opinions. Whether or not biases in auditor judgment are more often the result of an unintentional mechanism, there are important implications for international audit regulation since current rules of independence may not be effective against an unconscious and unintentional bias. Therefore, more regulation increasing penalties for corruption and punishing corrupt auditors (e.g., Sarbanes–Oxley Act) may not be the appropriate way to solve the auditing problem (Bazerman, Loewenstein, & Moore, 2002).

In this paper, we contribute to the literature by combining the auditor ethical decision model of Guiral et al. (2010) with the expertise model of Libby and Luft (1993) to analyze whether auditors' expertise is a potential explanatory variable which contributes to mitigate unconscious reporting bias. We found that auditors with higher expertise were less seduced by conflicts of interest in their decision-making processes. Our results also indicate that, while auditor knowledge (i.e., task-specific experience) makes auditors more reluctant to rely on the competing argument of the self-fulfilling prophecy effect, ability (i.e., degree of education) makes them more willing to perceive the "public watchdog" function as a critical issue of professional duty.

The rest of this paper is organized as follows. Section 2 introduces the discussion about the going concern decision-making process and its self-fulfilling prophecy effect. Section 3 summarizes the ethical model of Guiral et al. (2010). Section 4 introduces the expertise model of Libby and Luft (1993) as a potential explanatory variable of unintentional biases and hypothesis development, then presents a combined expertise-ethical decision-making model. Section 5 describes the experimental design. Section 6 reports the results and Section 7 discusses our findings.

The going-concern evaluation and the self-fulfilling prophecy effect

Audit standards require that auditors evaluate all relevant evidence in an unbiased and objective way. International Standard on Auditing (ISA) No. 570 requires auditors to assess the client's ability to continue as a going concern. If auditors believe there is substantial doubt regarding the client's ability to continue in existence (i.e., negative evidence), ISA No. 570 requires auditors to assess mitigating factors (i.e., positive evidence). If substantial doubt exists after considering all relevant information, then auditors must modify the audit report. Thus, from the standard-setter point of view, the going concern decision-making process should just rely on an analytical and objective evaluation. However, prior research has shown the going-concern evaluation may be subject to a range of biases that may affect how auditors perceive and process the audit evidence (for a review, see Smith & Kida, 1991; Nelson & Tan, 2005).

Although auditors should use all relevant evidence in an unbiased manner without being influenced by the outcome that judgment may ultimately imply, an important feature of the auditor's going-concern decision is its potentially self-fulfilling nature (Pryor & Terza, 2001). The nature of the self-fulfilling prophecy implies that the release of a going-concern opinion increases the likelihood of business termination due to the fact that investors, creditors, suppliers, and customers may tend to respond to this expert opinion by adjusting their behavior to agree with this opinion (Louwers et al., 1999). Empirical research has found that warning signals issued by auditors can hasten the demise of an already financially distressed company, reducing a loan officer's willingness to grant a line of credit to that troubled firm, or increasing the point spread that would be charged if that company was granted a loan (Guiral, Gonzalo, & Rodgers, 2007). Other examples of specific costs generated by the self-fulfilling prophecy are negative publicity, violation of debt covenants, and negative market reaction (Sainty, Taylor, & Williams, 2002).

Another underlying assumption is that auditors may fear being dismissed after the negative effects of the self-fulfilling prophecy (Citron & Taffler, 2001). Recent behavioral research indicates that auditors with higher expectations of the self-fulfilling prophecy had a greater sensitivity to mitigating evidence and a lower tendency to favor contrary evidence (Guiral et al., 2011).

Consequently, when auditors take into account the potential self-fulfilling consequences of their going-concern opinion, a conflict of interest may arise between the desire to reach an accurate evaluation (i.e., public interest) and the desire to reach a preferred conclusion that minimizes the adverse economic effects of a going-concern opinion (i.e., client interest). Even when an auditor is trying to be objective, the unconscious effects of a bias may dramatically affect how auditors perceive and process the information (Bazerman et al., 2002; Guiral et al., 2011; Moore et al., 2010).

An ethical decision making model

In an attempt to capture the role the self-fulfilling prophecy plays on the going-concern task, Guiral et al. (2010) have recently proposed an ethical decision-making model (see Fig. 1). This model separates the decision-making processes into four main processing stages: perception (P), information (I), judgment (J) and decision choice (D).