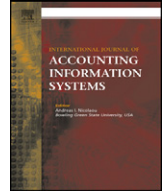




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When the world isn't always flat: The impact of psychological distance on auditors' reliance on specialists[☆]



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ABSTRACT

This study addresses recent calls for research on the conditions influencing auditor decisions related to PCAOB-encouraged reliance on third-party experts. To this end, the present study explores the effect of psychological distance on external auditors' reliance when induced through physical distance in a telework relationship between an auditee and a specialist. The reliance decision focuses on the auditee's contracting with a computer audit specialist who works remotely through a telework arrangement. The psychological distance associated with this telework arrangement is examined both in the context of variance in the physical distance of the computer audit specialist and the interactive effect of a contextual factor – the historical experience with an auditee's internal audit function. A 2 × 2 experiment with a total of 121 experienced Big 4 auditors is conducted in which psychological distance (physically proximate or remote specialist) and historical experience with an auditee's internal audit function (presence or absence of a prior year material weakness in internal controls) are manipulated. Consistent with predictions based on construal level theory, we find that psychological distance affects auditors' reliance judgment such that increased distance leads to lower reliance. Furthermore, the

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historical experience with the auditee's internal audit function creates a halo effect which moderates the effect of psychological distance such that the differential effect of a present vs. absent prior year material weakness on auditors' confidence and associated willingness to reduce budgeted audit hours is larger for a psychologically distant specialist. The results of this study suggest that an auditee's choice of a more proximate specialist may garner greater reliance by the external auditor, particularly when there is a material weakness in the prior year audit that the specialist is intended to help ameliorate.

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1. Introduction

With respect to IT audits of internal control processes, the enactment of the Sarbanes–Oxley Act of 2002 (SOX) profoundly affected the allocation of responsibilities among auditors and their clients' internal audit function (IAF). The Act both eliminated the option of outsourcing IT audits to incumbent auditors (SOX 201(a)) and substantially increased internal control system evaluation and documentation requirements (SOX 404) (Aguilar, 2005). The accompanying surge in compliance costs was frequently criticized in the business press as disproportionate (Blaskovich and Mintchik, 2007; Foster et al., 2007). Reacting to this criticism, the Public Company Accounting Oversight Board (PCAOB) adopted Auditing Standard No. 5 (AS No. 5), which allowed for audit fee reductions by explicitly encouraging auditors to increase audit efficiency through reliance on the work of others – including third party specialists engaged by management (Blaskovich and Mintchik, 2007).

Recently, audit researchers have highlighted the need for more research to fill the void in our knowledge and understanding of how the use of such third party specialists impact audit planning judgments (Messier, 2010). Our research focuses on the use of a teleworking, management-appointed specialist and the impact on auditor reliance. We focus specifically on the use of a management-appointed computer audit specialist. Pyzik (2012) highlights ancillary IT audit activities such as SOX compliance testing as among the easiest tasks for the IAF to outsource. Given today's technologies, the outsourcing of IT audit activities to a specialist does not necessarily require physical presence of the specialist at the organization's locale. A recent telework report highlights the prevalence of such work arrangements, indicating that approximately 8% of the 4th quarter 2010 working population in the U.S. engaged in telework on an almost daily basis – either as an employee or as a contractor (WorldatWork, 2011). With expected overall increases in telework arrangements among audit professionals (Hunton and Harmon, 2004; Nastase and Ionescu, 2011) and the growing popularity of global virtual teams (Prasad and Akhilesh, 2002), better understanding of the effect of physical distance on decisions rendered by parties collaborating with teleworking professionals is needed.

The purpose of this study is to examine how the psychological distance between a teleworking specialist and the external auditor influences the auditor's reliance on the work of the specialist. Specifically, this study investigates whether physical location of a teleworking computer audit specialist and historical experience with the auditee's internal control environment (i.e., the absence or presence of a prior year material weakness in internal controls over information systems access and security controls) influences auditors' reliance on the work of the specialist.

Although the physical distance between a teleworking specialist and the auditor should not affect the auditor's assessment of the quality of the specialist's work and hence the auditor's willingness to rely on such work, construal level theory (CLT) (Liberman and Trope, 1998; Trope et al., 2007) suggests that greater geographic distance correlates with greater psychological distance (Trope and Liberman, 2003, 2010; Trope et al., 2007) and hence prompts more abstract perceptions of geographically distant individuals (Liberman and Trope, 1998, 2009; Wilson et al., 2013), even when identical information is available (Henderson et al., 2006). Thus, auditors may fail to give adequate consideration to more specific, detail-level attributes of a distant specialist (e.g. specific skills or qualifications) which point to competencies and characteristics that would justify and encourage reliance according to criteria pronounced in AS No. 5. As a result, discrimination between proximate and distant specialists with respect to reliance on their work may occur. This argumentation is in line with a recent review of CLT research by Henderson and Waksak (2010) which concluded that distance is not as *dead* as argued by those who believe that technology has 'flattened' the world; distance continues to profoundly alter decision behavior in many settings.

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