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### Review

## The outcome effect – A review and implications for future research

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#### ABSTRACT

This paper synthesizes the extant research on the outcome effect in the accounting domain, focusing primarily on the context of performance evaluation. It reviews the current state of our knowledge about this phenomenon, including its underlying cognitive and motivational causes, the contexts in which the outcome effect is observed, the factors that influence its various manifestations, and ways in which undesirable outcome effects can be mitigated. It also considers various perspectives about the extent to which outcome effects represent undesirable judgmental bias, and whether this distinction is necessary to motivate research on this topic. The paper is intended to motivate and facilitate future research into the effects of outcome knowledge on judgment in the accounting context. Therefore, we also identify important unanswered questions and discuss opportunities for future research throughout the paper. These include additional consideration of instances in which the outcome effect is reflective of bias, how this bias can be effectively mitigated, ways in which outcome information influences judgment (regardless of whether this influence is considered normative), and how the underlying causes of the outcome effect operate singly and jointly to bring about the outcome effect. We also consider ways that future research can contribute to practice by determining how to encourage evaluators to retain and incorporate the relevant information conveyed by outcomes, while avoiding the inappropriate use of outcome information, and by enhancing external validity to increase the generalizability of experimental results to scenarios frequently encountered in practice.

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## 1. Introduction

Performance evaluations play a critical role in a number of accounting contexts, including managerial performance evaluation, capital budgeting decisions, and audit litigation arising from allegations of material financial misstatement. These evaluations are generally conducted after outcome information is available. Outcome knowledge can inform evaluations of the actions and decisions leading to that outcome, yet prior research has also found that possession of outcome knowledge systematically influences the evaluation in the direction of the outcome (e.g., Brown & Solomon, 1993; Brown & Solomon, 1987; Fisher & Selling, 1993; Ghosh & Ray, 2000; Ghosh, 2005; Lipe, 1993), a phenomenon known as *the outcome effect* (Tan & Lipe, 1997). When outcome information is diagnostic with respect to decision quality, it is of interest to both research and practice to develop an understanding of how and why evaluators incorporate this information into their performance assessments. When outcome information is not diagnostic with respect to decision quality, its incorporation into the evaluation of performance may introduce undesirable bias. Given the high stakes nature of many performance evaluations, it is important to determine when outcome knowledge biases judgment, and explore ways in which this bias can be mitigated.

This paper synthesizes the extant research on the outcome effect in the accounting domain to facilitate future research into the effects of outcome knowledge on judgment. We focus on performance evaluation, including managerial performance evaluation and audit litigation scenarios. Although this synthesis focuses on outcome effect research in accounting, we also include relevant papers from the psychology literature when they add significant clarity to our discussion. In general, these papers were cited heavily in the theory development sections of the relevant accounting studies. A full and complete discussion of the outcome bias literature in psychology is beyond the scope of this synthesis. Furthermore, we exclude related research (including hindsight effect research) unless it is required to inform our theoretical understanding of the outcome effect phenomenon.<sup>2</sup> To identify relevant studies, we searched ABI/INFORM, PsycARTICLES, Google Scholar and the Social Science Research Network (ssrn.com) using the following terms: *outcome effect*, *outcome focus*, *outcome bias*, *effects of outcome information*, *effects of outcome knowledge*, *hindsight bias*,<sup>3</sup> *outcomes in performance evaluations*, and *outcomes in performance appraisals*. We also reviewed the references from each paper identified during our search to ensure that we captured all relevant studies.

The remainder of this paper is organized as follows: we begin by discussing the importance of outcome effect research in accounting, and consider varying perspectives in the literature related to whether or not (and under what conditions) the outcome effect represents a judgmental bias. We then review research on (1) the underlying causes of this phenomenon, and (2) manifestations of the outcome effect in the accounting context.<sup>4</sup> We conclude by suggesting avenues for future research.

## 2. The outcome effect and judgmental bias

The accounting environment provides an ideal setting in which to study the impact of outcome information on judgment because a primary purpose of accounting is to capture, synthesize, and present relevant information to decision makers. Much of this information is historical in nature and includes outcome information. There are a number of accounting contexts in which the use of

<sup>1</sup> Each author contributed equally to this paper, which is based in part on Dr. Mertins' dissertation, chaired by Dr. Salvador.

<sup>2</sup> For instance, Helleloid (1988) focuses on the hindsight bias rather than the outcome effect, and does not add to our theoretical understanding of the outcome effect beyond that provided by the extant outcome effect research in psychology and accounting. Therefore, it has been excluded from this synthesis.

<sup>3</sup> We included this search term because some hindsight bias papers also addressed the outcome effect or provided theory that was utilized in outcome effect studies.

<sup>4</sup> A number of studies investigate the impact of various factors on the magnitude of the outcome effect using experimental methods. Although they consistently report that various factors do affect the magnitude of the outcome effect, these findings should be interpreted cautiously, as experiments are not an ideal methodology to identify the magnitude of effects in cases where manipulation strength can vary. We acknowledge and thank an anonymous reviewer for this insight.

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