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Does auditor gender influence auditor liability? Exploring the impact of the crime congruency effect on jurors' perceptions of auditor negligence

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ABSTRACT

This study investigates the liability risk associated with auditors' personal and financial conflicts of interest, and the potential for differences in liability exposure based on the gender of the auditor. A survey-based experiment was performed with 160 jury-eligible participants who reviewed a scenario in which an auditor, the defendant, failed to detect and report fraudulent behavior on the part of a client. The plaintiffs in this case are investors in the company who sustained financial losses due to the fraud, asserting that the audit firm should be liable for damages. A 2 × 2 between-subjects experiment examined how the auditor's gender (male/female) and the motivations of the alleged conflict of interest (personal vs. financial) influence jury-eligible individuals' perceptions of the defendant's independence and liability for negligence and fraud. Results indicate that female auditors are perceived as less independent and more liable for a *personal* conflict of interest, compared to male auditors. Male auditors are perceived as less independent and more liable for a *financial* conflict of interest, compared to female auditors. Auditors, regardless of gender, were perceived as less independent and more liable for a personal conflict of interest compared to a financial conflict of interest. The outcome of this study could be utilized to educate audit firms on the potential risks of liability that could emerge in unanticipated areas, and to assist with audit planning and legal decisions.

1. Introduction

Bias against auditors in a trial setting is a major concern noted in both research and practice. Some of these concerns arise as a result of an expectations gap between what the public expects from auditors and what auditors can viably accomplish from the audit process (Arrington, Bailey, & Hopwood, 1985). Other concerns arise from the potential for audit firms to be perceived as having "deep pockets" in the event of shareholder losses (Power, 1998). Such concerns have created an environment in which audit firms are more likely to settle out of court when accused of negligence, fearing the potential outcome of a trial with a biased jury (Schmidt, 2012).

This study expands on behavioral research on auditor liability to explore an additional source of bias: the auditor's gender. Behavioral law research suggests that jury members' perceptions of defendants are often influenced by gender stereotypes (Devine & Caughlin, 2014). Research on a phenomenon known as the crime congruency effect indicates a potential for gender bias based on the type of crime allegedly committed, and whether the crime fits the stereotypically predicted behavior of the accused (Maeder & Dempsey, 2013). If the accused is viewed as predisposed to the particular type of behavior aligned with the crime, judges and jurors are more likely to believe they committed the crime. Typically, male defendants are treated less favorably by judges and juries when they are accused of crimes that are viewed as stereotypically "male" (Pozzulo, Dempsey, Maeder, & Allen, 2010), such as those motivated by greed (Best & Williams, 1990). In contrast, crimes with an alleged emotional or sentimental motive are perceived to be more aligned with stereotypically "female" behavior (Best & Williams, 1990; Maeder & Dempsey, 2013). Overall, alignment between the gender of the defendant, the alleged motive, and the crime committed enhances the believability of accusations against the defendant, and increases the likelihood that the defendant will be blamed and punished for a crime (Maeder & Dempsey, 2013).

When auditors are accused of negligence or fraud, a lack of independence is often emphasized as the motive (Taylor, DeZoort, Munn, & Thomas, 2003). Typically, this motive is supported by evidence of conflicts of interest, emphasizing that the auditor's interests align too closely with the client to remain objective. This study applies emerging theory on the crime congruency effect to examine how gender stereotypes may influence perceptions of auditor independence and negligence, leading to juror bias against male auditors in some contexts, and female auditors in others. Specifically, the study explores how jurors perceive auditors accused of two different types of conflicts of interest as motives for the auditor to commit negligence: financial

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conflicts of interest (a stereotypically "male" motive) and personal conflicts of interest (a stereotypically "female" motive).

Financial conflicts of interest as a motive for auditor negligence have been noted in many past audit failures, such as Enron and WorldCom (Cullinan, 2004). In academic research, financially motivated aspects of an auditor negligence case, such as client importance and the involvement of non-audit service fees, have been shown to impact perceptions of auditor independence and liability (Brandon & Mueller, 2008). Past research has also noted the development of close professional relationships as a potential auditor independence issue (Moore, Tetlock, Tanlu, & Bazerman, 2006). This issue has emerged again recently as the SEC sanctioned a large public accounting firm in the U.S. over multiple incidents of close personal relationships with clients (SEC, 2016), clearly noting that such relationships have the potential to jeopardize the independent audit process. However, no research has examined how auditor gender influences liability risk under these conditions. This study seeks to expand on past research on auditor independence and social stereotypes to draw attention to the potential for both financial and personal conflicts of interest as a source of liability exposure for auditors, and highlight the impact of auditor gender on perceptions of liability in these contexts.

A 2 × 2 between subjects experiment was designed determine the impact of the auditor's gender (male vs. female) and the type of independence violation alleged (personal relationship vs. financial interests) on perceptions of auditor independence and negligence. 160 jury-eligible U.S. citizens were asked to determine whether they believed the auditor is liable and assess damages. Female auditors were predicted to be perceived as less independent and more liable in the event of a personal relationship with their client, and punished more severely than men in the same situation. Results are aligned with this prediction. The reverse effect is also supported when financial conflicts of interest were highlighted instead, such that male auditors are more harshly judged than female auditors when facing allegations of financial conflicts of interest. These findings indicate that jurors are not uniformly biased against a particular gender in an auditor liability trial setting, and the existence of a personal relationship prompts jurors to view female auditors more critically compared to male auditors. These findings indicate overall that gender is salient in a trial setting for both financial and personal conflicts of interest, such that women are penalized more harshly for personal conflicts of interest, and men are penalized more harshly for financial conflicts of interest. Results support an overall crime congruency effect, with a significant interaction between auditor gender and the alleged motive for negligence.

This research expands on previous research in the areas of auditor liability and behavioral law to provide valuable practical insights for audit firms in their establishment of rules of conduct, the determination of legal liability exposure for audit risk assessments, and deciding whether or not to pursue a trial or settle in the event of a lawsuit. Although most auditor negligence cases do not ever make it to a trial setting, knowledge of the potential outcomes can significantly influence the decision to settle, and the amount of a settlement. In the event of a trial, results of studies such as this could be used to develop trial strategy and plan for potential juror biases. The study also contributes to literature on social stereotypes and the crime congruency effect, further confirming that social stereotypes for gender apply to jurors' assessments of auditor liability.

The next section further discusses these concepts, and provides an overview of the relevant literature related to auditor independence, auditor liability, sex stereotypes, and gender bias in a trial setting to develop the proposed hypotheses for this study.

2. Literature review and hypotheses development

2.1. Auditor independence

When discussing the concept of auditor independence, it is important to distinguish between the concept of independence *in fact*, which is the actual state of being free from bias, and independence *in appearance*, which is how others will perceive the auditor's mindset. The majority of research conducted in the area of auditor independence attempts to measure the concept of independence *in fact*. These studies examine the impact of the auditor's individual characteristics and/or the context of the audit process on a proxy of audit quality. The assumption is that the higher the audit quality, the higher the implied independence of the auditor.

Results in this area are mixed, with findings suggesting that some measures of auditor independence, such as close client relationships, could have a negative effect on audit quality. The danger of a lack of independence due to close relationships and attachments with the client is that the auditor will be more susceptible to client pressures (Bamber & Iyer, 2007; Koch & Salterio, 2017; Koch, Weber, & Wüstemann, 2012). This phenomenon is often noted as an inherent bias due to the conflicts of interest built into the current structure of the audit profession and standard practices. Close social ties and attachments, such as previous work or university relationships between the auditor and client, have been found to influence audit opinions, abnormal accruals, and earnings restatements in subsequent years (Bamber & Iyer, 2007; Guan, Su, Wu, & Yang, 2016; Qi, Yang, & Tian, 2016). Some suggest that this bias may be overcome by obtaining more professional experience (Bamber & Iyer, 2007; Moore et al., 2006) and increased oversight (Koch et al., 2012).

Perhaps more relevant to this particular study is the concept of independence *in appearance*. Research in this area focuses on how others perceive auditors under different proxies of independence. Maintaining independence in appearance is extremely important for the auditing profession, as the public places trust in auditors to be gatekeepers for financial information (Olazabal & Almer, 2001). In addition, independence in appearance is important to decrease legal liability exposure and regulatory intervention (Kaplan & Mauldin, 2008). Studies about perceptions of auditor independence focus on how investors or jury-eligible individuals perceive auditors, and the impact that these perceptions may have on investment or liability decision-making processes. Results from actual regulatory actions or court cases may also provide important insights into how auditors are perceived by others. These findings are discussed in more detail in the section below, with implications for auditor liability exposure.

2.2. Evaluations of auditor independence in a trial setting

Accounting researchers have contributed to a growing body of knowledge examining the conditions under which auditors are exposed to the least amount of liability. One common stream of research identifies factors that are most likely to lead to litigation involving the auditor. These studies consistently find a link between increased auditor litigation and audit clients with a larger size, restatement activity, bankruptcy, and publicly traded status (Latham & Linville, 1998). Another stream of research in this area identifies the factors that are most likely to lead to a favorable outcome in litigation involving the auditor. This research focuses primarily on how variances in the audit environment and process may affect trial outcomes.

Although the current trend is for auditors to settle out of court, understanding how court decisions are made is still important. Audit firms and their legal counsel rely heavily on their expectations of what will occur in court to make decisions of whether or not to settle, and how much the settlement should be (Brandon & Mueller, 2008). As court proceedings are often complex, and the pool of litigation cases that result in actual trial outcomes with a judge and jury is quite small (Latham & Linville, 1998), the predominant method for examining litigation outcomes in this particular light has been in a behavioral context. This type of research can provide valuable insights about how suggested, pending, or recent changes in the audit environment can influence litigation outcomes. Therefore, the conclusions reached by