



## Perspective taking in auditor–manager interactions: An experimental investigation of auditor behavior <sup>☆</sup>



Bryan K. Church <sup>a,1</sup>, Marietta Peytcheva <sup>b,\*,1</sup>, Wei Yu <sup>c,1</sup>, Ong-Ard Singtokul <sup>d</sup>

<sup>a</sup> Scheller College of Business, Georgia Institute of Technology, United States

<sup>b</sup> Department of Accounting, College of Business and Economics, Lehigh University, United States

<sup>c</sup> Department of Economics, Hunter College, City University of New York, United States

<sup>d</sup> Chulalongkorn Business School, Chulalongkorn University, Charoen Pokphand Group Company Limited, Thailand

### ARTICLE INFO

#### Article history:

Received 17 September 2012

Revised 20 April 2015

Accepted 7 July 2015

Available online 25 July 2015

#### Keywords:

Perspective taking

Role-taking experience

Individual difference

Experimental economics

### ABSTRACT

We examine the effect of perspective taking on auditors' ability to evaluate managers' reported earnings and, in turn, contribute to high-quality financial reporting. Using an experimental-economics approach, we design two experiments to investigate auditor – manager interactions. In our first experiment, we manipulate auditors' prior experience in the manager's role. We predict and find that role-taking experience stimulates perspective taking, which allows auditors to more readily put themselves "in the manager's shoes," benefitting financial-reporting quality. In our second experiment, we examine dispositional perspective taking, focusing on individuals' propensity to spontaneously take the viewpoint of another, as a dimension of personality. We predict and find that auditors with high perspective-taking disposition are better able to judge managers' reported earnings than auditors with low perspective-taking disposition. Taken together, the results of our two experiments highlight the importance of perspective taking as a means to enhance auditors' performance in strategic interactions with managers.

© 2015 Elsevier Ltd. All rights reserved.

### Introduction

This paper reports the results of two experiments designed to examine the effect of perspective taking on auditors' ability to promote high-quality financial reporting. We define perspective taking as the capacity to entertain the psychological point of view of another (Davis, Conklin, Smith, & Luce, 1996). Our focus is on cognitive perspective taking, which entails understanding, as accurately as possible, another's thoughts, attitudes, or concerns in a specific situation (Epley, Caruso, & Bazerman, 2006). We use an

<sup>☆</sup> We gratefully acknowledge helpful comments from Jim Dearden, Jeffrey Hales, Mark Peecher, Timothy Shields, T. Jeffrey Wilks, Ping Zhang, and two anonymous reviewers, as well as participants in a workshop at Rutgers University and the 2010 Auditing Section Midyear Meeting in San Diego, CA. The authors acknowledge the financial support by the Scheller College of Business, Georgia Institute of Technology, a Faculty Research Grant and a grant from the Martindale Center at Lehigh University, and a research grant from Haslam College of Business, the University of Tennessee. We also appreciate the research assistance of John Castonguay, Lauren Reid, and Jonathan Shipman.

\* Corresponding author.

E-mail addresses: [bryan.church@scheller.gatech.edu](mailto:bryan.church@scheller.gatech.edu) (B.K. Church), [map608@lehigh.edu](mailto:map608@lehigh.edu) (M. Peytcheva), [wyl109@hunter.cuny.edu](mailto:wyl109@hunter.cuny.edu) (W. Yu), [ongard.sin@cp.co.th](mailto:ongard.sin@cp.co.th) (O.-A. Singtokul).

<sup>1</sup> The names of the first three authors are listed in alphabetical order.

experimental-economics approach to examine auditor–manager interactions, where players have conflicting interests. Specifically, we investigate *how* perspective taking affects auditors' assessment of managers' reporting choices, including auditors' propensity to identify and curtail reporting bias. We contend that successful perspective taking allows auditors to develop better mental models of clients' earnings, which leads to enhanced financial-reporting quality (Peecher, Schwartz, & Solomon, 2007).

Prior studies suggest that effective perspective taking improves individuals' judgments and decision making. Successfully taking another's perspective can reduce anchoring effects, confirmation bias, actor–observer bias, and in-group favoritism (Galinsky & Mussweiler, 2001). Moreover, being able to take the perspective of one's counterpart leads to more beneficial outcomes for self (Galinsky & Mussweiler, 2001). In an auditing context, Altiero, Kang, and Peecher (2014) document that auditors who are prompted to take an investor's perspective, by completing a series of investor-minded tasks, provide higher-quality materiality judgments than auditors who are not prompted. Our study complements Altiero et al. (2014) by examining the linkage between perspective taking and auditor behavior in strategic interactions with managers.

In our first experiment, we examine whether role-taking experience stimulates auditors' perspective taking. We contend

that role-taking experience enhances auditors' understanding of the manager's viewpoint, which benefits auditors' performance. Audit firms, especially the Big Four, have spent increasing amounts of resources to recruit former employees, commonly known as boomerangs (Badal, 2006; Deloitte, 2011). Firms' recruiting directors assert that auditors who return, after having spent time in industry, bring back "stronger knowledge, a broader sense of experience, a broader skill set" to the firm (Hyland, 2006). Our experiment sheds light on an advantage that accrues to audit firms by hiring employees from industry.

We manipulate auditors' prior experience in the manager's role (experience versus no experience), examining its effect on auditors' behavior. We predict and find that role-taking experience stimulates perspective taking. Auditors with role-taking experience more accurately estimate managers' reported earnings, as compared to auditors without such experience, and in turn make better reporting decisions, which promotes high-quality financial reporting.

We design a second experiment to further investigate the effect of perspective taking on auditors' capacity to evaluate managers' reported earnings (i.e., to assess whether earnings are materially misstated). We focus on dispositional perspective taking, representing individuals' natural ability to spontaneously take the viewpoint of another. Our second experiment allows us to cleanly examine the effect of perspective taking on auditor-participants' task performance, apart from the effect of situational factors that also might influence perspective taking. We use an established personality measure to appraise auditor-participants' perspective-taking disposition (Davis, 1980, 1983). We find that auditors with high perspective-taking disposition are better able to judge managers' reported earnings than auditors with low perspective-taking disposition. This result suggests that perspective-taking disposition is an important individual trait that underlies auditors' performance. Accordingly, our study complements other auditing-based research that investigates individuals' characteristics, including dispositional tendencies (e.g., Bonner & Lewis, 1990; Hurr, 2010; Majors, Shefchik, & Vitalis, 2014; Rose, 2007; Scofield, Phillips, & Bailey, 2004).

Our study makes several contributions to the extant literature on audit quality. First, we provide evidence that perspective taking improves auditors' ability to accurately assess managers' reported earnings. The takeaway is that effective perspective taking is beneficial to audit quality. Second, we provide evidence that role-taking experience stimulates perspective taking. Furthermore, some individuals quite naturally are better at perspective taking than others, aside from the effects of role-taking experience. Those who are better at perspective taking, in turn, may have an advantage in strategic interactions as compared to others. Third, our findings suggest that auditors who possess better mental models of true earnings, indeed, are able to make better decisions, which enhances financial-reporting quality (Peecher et al., 2007). While this link often is assumed in the literature, we are able to provide empirical evidence of its validity. We suggest that auditors might benefit by making earnings estimates of reporting segments as a way to judge the sufficiency and accuracy of their mental models for a client's overall earnings process (see also Budescu, Peecher, & Solomon, 2012).

The results of our two experiments, taken together, have important implications for audit practice. First, audit firms can benefit from hiring auditors with prior experience in the corporate world, especially those involved in the financial-reporting process. Audit firms' efforts to recruit accountants from industry, including boomerangs, appear to be prudent as industry experience may aid perspective taking (i.e., anticipating managers' behavior and actions). Second, audit firms can benefit from targeted training programs that involve role taking. Such training programs potentially represent an efficient means to boost audit quality. As pointed out by Trotman, Wright, and Wright (2005), role-taking

training is a relatively low-cost technique, as it can be conducted with other participants from the same firm. Third, audit firms may want to consider dispositional perspective taking in staffing assignments, for example, ensuring that some team members have high perspective-taking disposition. The importance of including such individuals on audit teams likely is magnified when the auditor and client are involved in resolving significant disagreements over accounting matters. Lastly, audit firms are advised to consider other ways to facilitate perspective taking (e.g., prompts in audit programs) as a means to improve auditor performance and, ultimately, audit quality.

The remainder of this paper is organized as follows. Section 2 reviews the related literature, which provides a basis to develop our research hypotheses. Section 3 describes our first experiment, and Section 4 presents the experimental results, along with a discussion of the findings. Section 5 describes our second experiment and, subsequently, presents the results. Section 6 offers concluding remarks.

## Background, theory, and hypotheses

### Background

The importance of perspective taking in cognitive processes is examined extensively in Piaget's (1932, 1950) early work. Individuals take another's perspective by simulating another's internal states, and the form of simulation can vary depending on task demands (Niedenthal, Barsalou, Winkielman, Krauth-Gruber, & Ric, 2005). The aim of perspective taking is to put oneself "in another's shoes" and to effectively take another's vantage. Prior studies document numerous cognitive benefits of successful perspective taking, which arise in various social interactions (e.g., Davis et al., 1996; Galinsky & Moskowitz, 2000; Galinsky & Mussweiler, 2001; Galper, 1976; Johnson, 1967; Johnson & Johnson, 1982; Regan & Totten, 1975; Sessa, 1996).

Altiero et al. (2014) investigate perspective taking in an auditing context, noting that regulatory standards require auditors to consider investors' perspective when assessing materiality. The authors conduct an experiment, with experienced auditors as participants, and use a series of investor-minded tasks to stimulate auditors to actively take an investor's perspective. The findings indicate that prompting auditors to take the investor's perspective, by using investor-minded tasks, enables them to discriminate between potential audit adjustments that are more or less likely to be material for qualitative reasons. Otherwise, auditors fail to make the distinction. The results hold for both specialist and non-specialist auditors, but are more pronounced for specialists.<sup>2</sup> These findings underscore the importance of successful perspective taking as a means to reinforce audit quality.

As compared to Altiero et al. (2014), we examine perspective taking in strategic interactions with managers. We maintain that perspective taking improves auditors' strategic reasoning – the process whereby an agent reasons about the best strategy to adopt in a multi-player scenario, taking into account the likely behavior of the counterpart(s).<sup>3</sup> Without question, strategic reasoning is an

<sup>2</sup> When prompted, specialist auditors draw upon rich, domain-specific knowledge, permitting them to hone in on qualitative facets of materiality, which affects their evaluation of potential audit adjustments (e.g., whether adjustments affect the trend of key performance indicators).

<sup>3</sup> In strategic interactions, zero-order reasoning occurs when agents consider their own incentives, but not their counterparts' incentives. Zero-order reasoning involves "no understanding of the desires, beliefs, or thoughts of others" (Hedden & Zhang, 2002) and can lead to myopic choices. In contrast, higher-order reasoning involves strategic consideration of the incentives of one's counterparts as well as consideration of counterparts' beliefs about, and anticipation of, one's own incentives (Colman, 2003; Hedden & Zhang, 2002; Perner & Wimmer, 1985).

Download English Version:

<https://daneshyari.com/en/article/878566>

Download Persian Version:

<https://daneshyari.com/article/878566>

[Daneshyari.com](https://daneshyari.com)