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DEVELOPING A CONCEPTUAL MODEL FRAMEWORK ON SETTING NEGOTIATION STRATEGIES IN AUDIT DECISION-MAKING PROCESSES

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Abstract: *Motivational factors and bargaining power are considered important elements for negotiation strategies by scholars and academics. However, there is few evidence up to date on the effect of these factors in the context of auditor client negotiation while adopting a decision making process framework. Therefore, the objective of this paper is to presents a Conceptual Model Framework that describes the decision-making process of auditors in terms of negotiation strategies. The research methodology involves the application of a thoughtful model that contains the the following elements: (a) perception motivational factors, and (b) bargaining power affecting the choice of negotiation strategy, and also identifies different pathways auditors use in their decision about negotiation strategies. Results show that only engagement risk perception influences the auditor to accept aggressive accounting treatments of the client. Further, it influences the use of all the negotiation strategies. On the other hand, client pressure has effect on compromising strategies, while bargaining power influences the concessionary strategy of auditors.*

Keywords: *engagement risk, client pressure, bargaining power, conceptual model, decision.*

JEL Code: M42

Introduction

The main objective of the current research resides in defining a conceptual model framework on setting negotiation strategies in audit decision-making processes. Further, this can be split into three secondary objectives, that underline the relevance of our study: applying the model from the perspectives of engagement risk, client pressure, and bargaining power.

Often auditors face conflicts of interest concerning their professional duty of providing an opinion about the real economic situation of the firm they are auditing because they try to keep good relationships with their client. This conflict of interest has roots in a series of corporate scandals that occurred in 2003 when auditors have been accused of being accomplices with client management in biasing financial reports (Levitt and Dwyer, 2002). It is logical to believe that auditors who are hired and paid by managers have interest to find means to persuade mangers to record appropriate audit adjustments when it is needed and hence avoid providing negative audit opinions and keep good relationship with managers.

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Auditors often deny that they negotiate with their clients and claim that their judgement is unaffected by such conflicts of interest. Furthermore, they believe that these criticisms mainly derive from unfair academicians (Moore et al., 2006).

However, both recent events and recent research confirmed the impact of conflict of interest on auditor's decisions. Moore et al. (2006) advanced that auditors' opinion is influenced by these conflicts of interest and the fact that auditors are not always conscious of this bias.

Because conflicts of interest are not avoidable and cannot be reduced to zero (Moore et al., 2006), a successful auditor is the auditor who succeeds to find means to navigate these conflict of interest. Thus, negotiation is considered a tool which enables auditors to successfully navigate these conflicts of interest in a legitimate way.

Literature review

Evidence suggests that auditor's judgement is unconsciously influenced by conflicts of interest. This fact can also help explain why auditors use concessionary negotiation strategies in certain circumstances.

Generally, researchers tackled the auditor independence problem under the economic approach which assumes that auditor choose to exercise the auditing task in a honest way and provide unbiased reports to investors or to be accomplice with client management in misleading investors (DeAngelo, 1981; Antle, 1984; Simunic, 1984). However, the research line of motivated reasoning and self-serving biases challenged this assumption, and advanced that the impact of conflict of interest should be explained by the unconscious bias rather than intentional corruption.

Research on unconscious bias suggests that individuals fail to evaluate the information objectively and tend to consider their self-interest at first. In fact, individuals always think they deserve more when they allocate resources (Messick and Sentis, 1979). Arguments that are in line with individuals preferences are often easy to find and people emphasis these arguments when they make decisions (Messick and Sentis, 1979; Diekmann, 1997; Diekmann et al., 1997) , for this reason auditors should be aware of the impact this selective perception bias has (Thompson and Loewenstein, 1992; Babcock and Loewenstein, 1997).

Individuals seem to emphasis evidence that enables them to reach the conclusion they want to achieve. Hence the degree of self-interest influences auditors' focus on that particular evidence (Holyoak and Simon, 1999). This explains why for the same audit issue auditors use different negotiation strategies, while facing various contexts.

When they cannot ignore conflicting evidence and the accounting issue at hand is complex, auditors often engage in distribution strategies (conceding or contending) and less in integrative strategies. This depends on the degree of self-interest, that is if their self-interest is threatened like a great litigation exposure, they will use contending strategies, and will threaten to qualify audit reports if clients do not record audit adjustments. On the other hand, auditors chose to concede to their client's preferences if they are threatened to lose their clients.

Biased judgement are more likely to appear when people just confirm evaluations made by others than when they give estimation from the scratch. Diekmann et al. (1997) confirm this evidence. The duty of auditors is to approve the compliance of client's reports to the GAAP. This makes auditors more inclined to accept the client's reports.

Many have argued that audit firms are made to choose between loosing a client and the uncertain risk of a harsh litigation penalty on the other. Researchers argue that the choice is in favour of the risky option (Kahneman and Tversky, 1979). In this context, accounting firms seek to develop relationship with client and even develop a business partnership. This is possible by reconciling the immediate certain effect of losing the clients and the uncertain future legal costs. When financial incentives contradict professional obligations, auditors may be induced to respect their client wishes. Conflicts of interest are definitely considered as an obstacle for auditors to make objective estimations, although professionals rarely admit that their judgement is influenced by conflicts of interest.

In his testimony before the SEC, Gary Shamis, then chairman of the Management of an Accounting Practice Committee of the AICPA, stated, “We take the existing independence rules quite seriously, and consequently abide by all the existing rules. We are professionals that follow our code of ethics and practice by the highest moral standards. We would never be influenced by our own personal financial well-being” (Shamis, 2000). Moore et al. (2006) consider that these noble sentiments do not guarantee objective judgement.

Research design and methodology

The model as shown in Figure 1 has four components: perception (P), information (I), judgment (J) and decision (D). As claimed by this model, perception and information leads to judgment in a first phase then perception and judgment leads to a decision in a second phase. The perception concept indicates that decision makers frame situations based on their experience, training and education. Further, based upon the strength or weaknesses of these elements, decision makers may employ heuristics and biases in the perception stage (Kahneman and Tversky, 1979). This model proposes that information and perception are interdependent as it is illustrated in (fig. no.1 by the double- ended arrow, and that judgment is a joint product of information and perception.

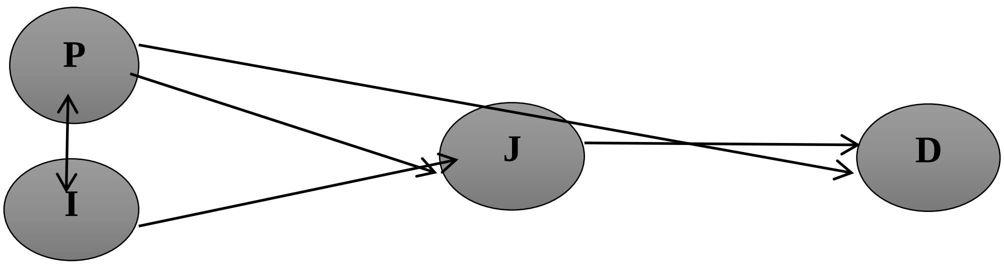

Fig. no. 1 The throughput conceptual model

Source: Rodgers (1997) “Throughput Modelling: Financial information used by decision makers » JAI Press, Greenwich, CT.

This model highlights six critical pathways (between the four components identified above) in the decision making process while eliminating rival alternative hypotheses. I propose matching these pathways with 6 theories of ethical behaviour to explain how auditors choose negotiation strategies. These pathways and related ethical theories are defined and discussed below.

(*1) P→D. Ethical egoism*. In this pathway, an action is considered ethically correct when it maximizes one’s self interest (Rodgers and Gago, 2001; Rodgers et al., 2009). According to this reasoning, the decision is based upon the perceived circumstance, downplaying any relevant information and judgment. Thus, the decision maker’s perception will directly influence the decision.

(2) P→J→D. The deontology position. In this pathway, the decision maker is committed to independent moral rules or duties, thus equal respect must be given to all individuals. Focus is on

taking the right actions rather than on the consequences of the actions. In this pathway, rules and laws are framed and judgment (J) made by how the situation is perceived (P), before a decision is made (D).
(3) I→J→D. The utilitarian position. This pathway emphasises the maximisation of the good and the minimisation of harm to a society. Therefore, available information (I) is used in an objective manner throughout the analysis (J) before a decision is made (D). The decision maker's perception (P) is not considered.
(4) I→P→D. The relativism position. This pathway considers ethical standards based on the decision makers themselves or people around them. In this light, ethical beliefs are not absolute but depend on circumstances. Therefore, available information (I) will influence individual perception (P) before a decision is reached (D).
(5) P→I→J→D. The virtue ethics position. This pathway doesn't consider what makes a good action but rather focuses on what makes a good person. Perception (P) will thus influence the selection process of the information (I) (ensuring that the selected information is consistent with being a good person) which leads to the judgement stage (J), *en route* to a decision (D).
(6) I→P→J→D. The ethics of care position. This assumes that people are willing to listen to distinct and previously unacknowledged perspectives. Thus all the relevant information (I) is considered and it influences perception (P). The resulting perceptions are analysed in a judgment (J), *en route* to a decision (D).

Results and discussions

Understanding the role of different components used by negotiators in their decision process is critical to understanding the decisions of negotiators. The TP model was proposed to describe the auditors' negotiation strategy selection process since its six dominant decision-making pathways relate to the foundation of the negotiation strategies. The TP modelling approach allows for an analysis of the potential effects of auditors' perception of their negotiation situation on their decision choice of a particular negotiation strategy. This is important because parties to a negotiation engage in the negotiation as they perceive it rather than from some objective view.
The following discussion clarifies the elements of perception (P), information (I), judgment (J) and decision choice (D) in a negotiation context. These components are also summarized in (table no. 1).

Perception (of contextual features). These are conditions, biases or any other factors that can influence how the auditors interpret negotiation situations. This covers what Gibbins et al. (2001) referred the "antecedent conditions", these includes negotiators' experience, history and relationship. The contextual features are grouped according to three main groups: the primarily external features (nature of the accounting and auditing standards, engagement risk, audit committee characteristics etc.), the primarily interpersonal factors which include the nature of auditor- client relationship, and the primarily "capabilities" factors which involves parties knowledge and skills (Gibbins et al., 2010).

Information. It consists of the accounting issue under negotiation and any other objective facts that affect the negotiation process such as account balances that have not been audited and analysts' forecasts. The negotiation issue may rise as a result of the auditor or the client's actions, or even be due to an external issue such as the release of a new accounting standard.

Judgment. After receiving information related to the accounting issue in the first stage, parties interpret and analyse carefully the issue relying on the analytical techniques acquired from the auditing exercise. This will allow the choice of the most preferred alternative (Gibbins et al., 2001). The auditor then has to see if there is any overlap with the client's preferred position and to what extent it is feasible to reach an agreement with the client.

Decision Choice. The decision choice refers to the selection of a negotiation strategy. At this stage the auditor chooses among a set of strategies (contending, conceding, compromising, or integrative) one strategy that they will use to negotiate the accounting issue with the client.

Table no. 1 Auditor client negotiation modeled in the Concept Model

1. Perception	The auditor selects a negotiation strategy based on his perception of the accounting context: Engagement risk, bargaining power as well as perceived auditor client relationship.
2. Information	All the relevant information to the course of the negotiation such as information as represented by balances and financial ratios that have not been audited.
3. Judgement	Analysis of the potential alternatives available in order to determine a position on the issue by providing an independent estimate of the account balance, and detecting potential overlap between his situation and that of his counter party.
4. Decision	The auditor decides on negotiation strategy and tactics: concede, compromise, contend, integrate that enables him to reach his objective.

Source: own projection

In negotiating, the first stage (fig. no.1) involves framing of the contextual features of the negotiation environment and this may include perceptual biases that the auditor might have regarding the client's environment and incentives factors as depicted by the engagement risk and client pressure. This stage also involves the use of information like account balances (not audited) and any other information, internal or external that is judged relevant in the course of negotiation, and could affect the auditors' decision choice. The double-ended arrow connecting perception and information in figure 1 represents this relationship. For example, the auditors' evaluation of the balance that has not been audited, analyst forecasts, as well as expected income may be highly correlated with auditors' perception of the contextual environment such as the engagement risk and client importance.

Next, in the judgment stage, the contextual features (P) and financial and non-financial information (I) are analysand and weights are placed on key information items. This gives the auditor the ability to develop and compare a wide set of alternatives given the increased ambiguity of accounting standards and to select a strategy in the decision choice stage (D). Auditors employ investigatory and analytical tools to diagnose the cause of a problem. Both deductive and inductive reasoning are required for effective diagnosis as shown by the direct arrow leading from information to judgement in Figure 1. For instance, Rodgers and Housel (2004) state that "auditors employ investigatory and analytical tools to diagnose the cause of problem" as illustrated by the direct arrow from information to judgment in (fig. no. 1).

The following discussion illustrates the negotiation strategies that the auditor is able to select given the independent variables. The strategy choices are the dependent variables in this research. In this section, we discuss the effect of the variables of the framework upon the auditor's choice in the light of the Conceptual Model. We investigate three potential influences audit perception on contextual features of auditor's negotiation strategy: client engagement risk, client pressure and bargaining power (besides the influence of financial information). These possible effects are the independent variables in this research. (Fig.no. 2) summarizes the theoretical model by illustrating how these variables are expected to have an impact both on auditor's negotiation strategy and his/her judgement about the extent she/he will accept management's alternative and the amount she/he requires to be adjusted by the client(the figure showing details about variables measures is explained later). Below, we develop our hypotheses in detail.

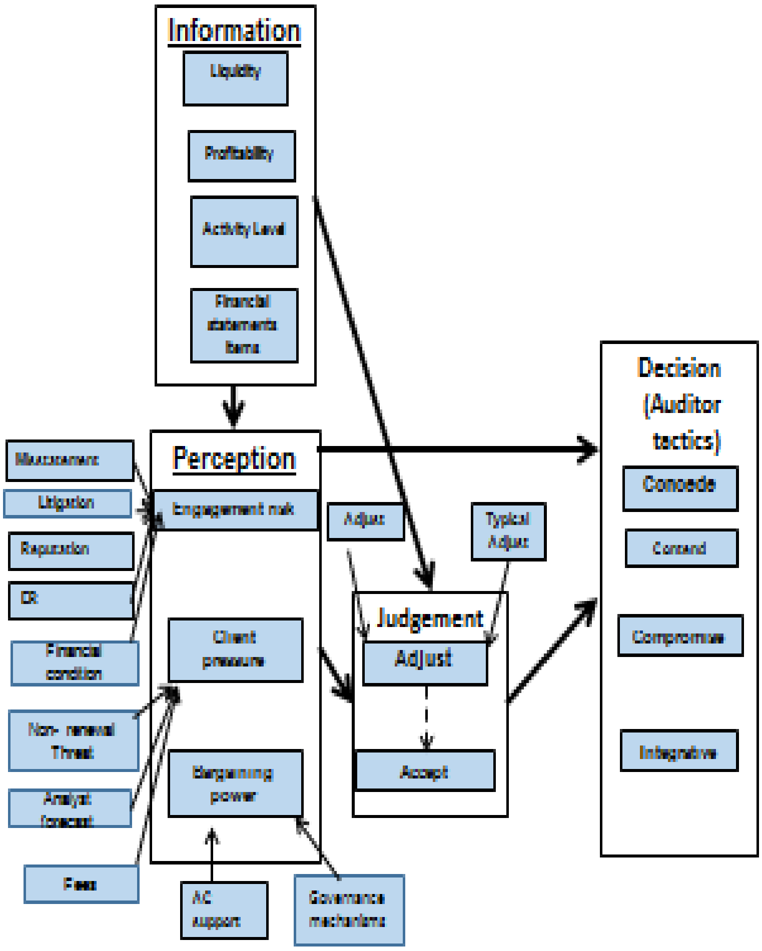

Fig. no. 2 Model of auditor's negotiation strategies decision choice
Source: own projection

Notes:

CORPORATE GOVERNNACE – the CORPORATE GOVERNANCE as perceived by the auditor is measured by four items constructs and has 2 experimental conditions:

- *The corporate governance mechanisms are strong;*
- *The corporate governance mechanisms are weak.*

ENGAGEMENT RISK – the engagement risk is:"the risk that the audit firm will suffer a loss via litigation , loss of reputation or costs exceeding fees" (AICPA 1983;

Johnstone 2000, Belle et al 2002) is measured by three items constructs and has two experimental conditions:

- *Auditor perceives client engagement risk as high;*
- *Auditor perceives client engagement risk as low.*

CLIENT PRESSURE – Auditor's Perception of Client pressure: is - Client importance and client's ability to meet the analysts' forecasts is measured as three items constructs and has 2 experimental conditions:

- *Auditor perceives client pressure as high;*
- *Auditor perceives client pressure as low.*

ACCEPT: likelihood of accepting the accounting alternative of management
ADJUST: The amount required to be adjusted by client management
FI: company's financial ratios
AUDITOR TACTICS – Auditor's Intended Use of Tactics: the auditor's decision about the negotiation

Previous research suggested that the client financial condition influences auditor's engagement risk assessment, precisely the probability of the auditor suffering from loss resulting from an engagement is found to be positively related to the financial condition distress (Palmrose, 1987; Schipper, 1991; Stice, 1991; St. Pierre and Anderson, 1984).

The findings of Asare et al. (1995) study reveal that audit partners perceive that the client's business risk as represented by financial condition and the audit risk as represented by inherent risk and control risk determine their perception of the engagement risk. Similarly, poor financial performance of the client may result in a non- payment of the audit fees which affects the auditing firm profitability therefore its engagement risk. Furthermore, client's business risk is found to have serious legal consequences on the auditing firm.

The table below provides a summary of the research hypotheses and the results obtained in our study by applying the Conceptual Model.

Table 2 Research assumptions summary

Independent Variables	**Pathway**	**Assumptions**	**Findings**
Engagement Risk			
	I➔P	Financial information influences negatively auditor's perception about firm's engagement risk.	Not supported
	I➔J	Financial information influences negatively auditor's judgement about the likelihood of rejection of management's alternative and the amount to be adjusted.	Not supported

	P➔J	engagement risk perception influences negatively the judgement of rejecting aggressive client accounting policy choices and the requirement of audit adjustments to bring the client accounting treatment into conformance with GAAP.	Supported
	J➔D	Greater acceptance of client alternative is more likely to result in the auditor employing conceding tactics and less likely to result in contending tactics.	Supported
		Greater acceptance of client alternative is more likely to result in the auditor employing Integrative strategies.	Supported
		Greater acceptance of client alternative is more likely to result in employing compromising strategies.	Supported
	P➔D	Greater perceived engagement risk is more likely to result in auditors employing conceding tactics, compromising strategies and integrative strategies but less likely to result in contending strategies.	Partially Supported (direct effect on integrative strategies only)
Client pressure			
	P➔J	Greater perceived client pressure is less likely to lead to a rejection of aggressive client accounting policy choices and to the requirement for larger audit adjustments to bring the accounting treatments into conformance with GAAP.	Not supported
	J➔D	Higher acceptance of management's alternative is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship).	Not supported

	P➔D	Greater perceived client pressure is more likely to lead the auditor to use compromising negotiation tactics (i.e., a positive relationship)	Supported
Bargaining Power			
	P➔J	Greater perceived bargaining power is more likely to lead to a lesser willingness to accept aggressive client accounting policy choices and to the requirement for higher adjustments to client accounting to bring the accounting into conformance with GAAP	Not supported
	J➔D	Higher acceptance of management alternative leads to conceding negotiation strategy.	Not supported
	P➔D	Weak perceived corporate governance leads to conceding negotiation strategy.	Supported

Source: own projection

Conclusions

The analysis performed in the current study applies a set of elements, namely: engagement risk perception, client pressure, corporate mechanisms strength, as well as financial information. In addition, this paper investigates their effects on auditor decision making about the likelihood of accepting client's management alternative and on the negotiation strategies choice. Results show that only *engagement risk perception* influences the auditor to accept aggressive accounting treatments of the client. Further, it influences the use of all the negotiation strategies. On the other hand, *client pressure* has effect on compromising strategies, while *bargaining power* influences the concessionary strategy of auditors. Moreover, two dominant decision making pathways are used by auditors (i.e. P➔J➔D and P➔D). This research contributes to extending the academic knowledge on audit decision making, not to mention its applicability for the corporate business environment. Further studies can be developed on this topic, as audit decision making models will always be of interest for scholars and academics.

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