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Evidence About Auditor–Client Management Negotiation Concerning Client's Financial Reporting

MICHAEL GIBBINS,* STEVEN SALTERIO,† AND ALAN WEBB*

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ABSTRACT

We develop a model of auditor-client accounting negotiation, using the elements of negotiation examined in the behavioral negotiation literature, elaborated to include accounting contextual features indicated in the accounting literature and suggested by interviews with senior practitioners. We use a questionnaire structured according to the model to describe the elements, contextual features and associations between the two groups in a sample of real negotiations chosen by 93 experienced audit partners. The paper demonstrates important aspects of the sampled accounting negotiations and makes suggestions for further empirical and model development research.

* School of Business, University of Alberta; †School of Accountancy, University of Waterloo.
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1. Introduction

This paper provides evidence about negotiation by the external auditor with client management ("auditor" and "client" hereafter) concerning the client's financial reporting. The evidence, from a field questionnaire, is organized by a three-element negotiation process model that incorporates both the negotiation setting and its associations with accounting contextual features. Any auditor-client negotiation of the client's financial statements information (usually just called accounting negotiation henceforth) affects the flow of accounting information to investors and other information users (e.g., Burgstahler and Dichev [1997]). Our results show that accounting negotiation can affect the financial statements materially, that senior accounting partners experience negotiations as a normal part of their practice, and that, when negotiations occur, they are important to the parties involved.

This paper's analysis integrates the general negotiation literature and a diverse accounting literature that identifies various contextual features that might affect accounting negotiation. The analysis presents the auditor as actively participating in the client's accounting and disclosure choices (e.g., Demski and Frimor [1999]). Employing the literature and supported by interviews, we developed a three-element accounting negotiation process model and used it to design a field questionnaire. Our objective is to provide initial descriptive evidence and a basis for further modeling and empirical research in accounting negotiation.

The questionnaire was completed by 93 international public accounting firm audit partners, none having less than 10 years' experience and most having over 20 years' experience. For these senior practitioners, negotiation is common, 67% of the partners experiencing it with 50% or more of their clients. The partners chose negotiation examples which generally were recent, involved a public company that had been a client for at least 3 years and many senior people on both sides, and took weeks to complete. The negotiated issues typically had several accounting and disclosure implications, were always material, and frequently arose because of unclear or non-existent GAAP. Nearly all negotiations resulted in agreement and were followed by the reappointment of the auditor.

The negotiation process is situated in the on-going auditor-client relationship and is defined by important contextual features: external conditions and constraints, interpersonal factors and parties' capabilities. Numerous associations between negotiation process elements and accounting contextual features are documented. The results refine the basic model and indicate areas where more investigation would be useful.

We begin by integrating the general negotiation literature and relevant accounting research to develop a three-element accounting negotiation process model (section 2) including a set of defining accounting contextual features (section 3). Our structured field questionnaire provides evidence on the negotiation process and accounting contextual features (sections 4, 5, and 6). We conclude with a discussion of results and research implications (section 7).

2. *The Three-Element Accounting Negotiation Process Model*

2.1 BASIC NEGOTIATION PROCESS MODEL

We define negotiation as any context in which two or more parties with differing preferences jointly make decisions that affect the welfare of both (all) parties (Murnighan and Bazerman [1990]). We focus explicitly on negotiations and do not examine the effects of the auditor on the client's accounting and disclosure through the routine provision of advice about appropriate accounting policies and disclosures (see Salterio [1994, 1996] and Salterio and Koonce [1997] for examples of this). The process begins with the negotiation *issue,* which exists in the context of past negotiations and relationships between the parties. Various choices and actions constitute the negotiation *process.* The result is the negotiation *outcome.* Each negotiation becomes an antecedent for the next one. The issue, process and outcome are the elements of the basic model of negotiation (Kennedy [1992], Pruitt and Carnevale [1993]) adapted to auditor-client accounting negotiation in this paper. These elements, the antecedent history and the potential for future interaction are shown at the top of figure 1, which collects the

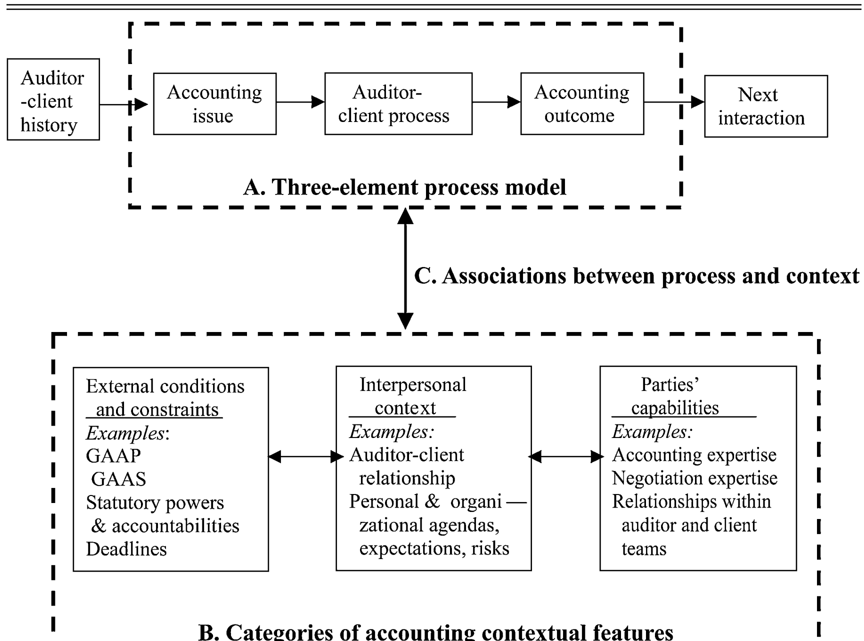

FIG. 1.—The accounting adaptation of the basic negotiation setting and categories of accounting contextual features.

three central elements into box A. Later we address the contextual features (box B) and the associations between the two boxes (arrow C). First, we explain the three elements more fully.

2.2 THE ISSUE TO BE NEGOTIATED

The general negotiation literature identifies framing of the issue as an important factor (e.g., Babcock et al. [1995]; Bottom and Studt [1993]; de Dreu et al. [1994]). Most negotiation research, whether analytical or empirical, begins with an identified issue or set of issues to be negotiated (Bazerman [1990], Raiffa [1982]). Hence, participants can anticipate the negotiation and plan accordingly (Babcock, Wang, and Lowenstein [1996]). It is unlikely that in the accounting context, issues arise in such an orderly fashion (Gibbins and Newton [1994], Salterio and Denham [1997]). Describing the characteristics of the issue in accounting negotiations requires identifying the accounting implications, the materiality of the issue, how the issue arose, and whether the issue was a surprise (a surprise implying a "first mover" advantage to the party identifying the issue).

2.3 THE NEGOTIATION PROCESS

Two basic factors from the general negotiation literature are important for this paper's analysis. First, negotiators are self-interested, rational agents (Raiffa [1982]). Negotiation is a calculated, strategic activity informed by each party's knowledge, perceptions, preferences and beliefs, and takes time (Thompson [1990]). The rationality can be considered from the point of view of a single negotiator representing the client or auditor, or of negotiators within each party. Second, the private information of the parties is unequal, at least at the outset (Bazerman [1990], Pruitt and Carnevale [1993]). Unequal initial information allows for different initial beliefs and differing preferences. Characteristics of the accounting negotiation process include its duration, the number and seniority of the people involved on behalf of both the auditor and client, and the initial beliefs of those people about possible outcomes.

2.4 THE OUTCOME

A negotiation may have a variety of outcomes, which may coincide with either, both or neither party's initial preferences. The general negotiation literature provides insights into two principal types of bargaining leading to different types of outcomes. Distributive bargaining involves dividing a fixed set of resources, leading to a "distributive" solution where one party or both end up with losing positions (Bazerman [1986]). Integrative bargaining involves jointly producing an integrative solution where both parties are better off (Bazerman [1986]), often by incorporating other issues than the original focus of the negotiation, providing room for both parties to gain some advantage. Behavioral negotiation research has shown that even when there is a potential for integrative solutions, these are rarely found (Neale and Bazerman [1991]). In the accounting negotiation setting, one outcome is the contents of client's financial statements. Others would be the auditor's opinion on the statements, whether the auditor is reappointed, and the career and personal importance of the outcomes to the audit partner.

3. Principal Accounting Contextual Features Important to Negotiations

3.1 THE ACCOUNTING CONTEXT OF THE PROCESS MODEL

This section develops in more depth the accounting contextual features associated with and providing practical meaning to the process model. Given the relative paucity of accounting research literature on negotiations, we developed our model by relying both on the literature and on a series of interviews carried out with eighteen senior practitioners in both individual and group settings. The six individual interviews were with national office partners of large public accounting firms while the group session involved twelve members of the Canadian Emerging Issues Committee (similar to the Emerging Issues Task Force in the U.S.). We derived three general groups of contextual features based on the interviews and the literature analysis: the role of external conditions and constraints, the interpersonal auditor–client context, and the capabilities of the parties including accounting expertise.

Box B of figure 1 illustrates the categories of accounting contextual features that guide the discussion below. Those features potentially influence or are influenced by any of the three negotiation process elements. For example, GAAP may influence how the accounting issue is defined, the alternatives considered during the process and the interpretation of the outcome. Going in the other direction, a slow negotiation process may exacerbate deadline pressure and strain relations among negotiation participants. The potential for multiple associations between the box A elements and box B context features is indicated in figure 1 by arrow C.

3.2 EXTERNAL CONDITIONS AND CONSTRAINTS

We begin with this category of contextual features because of their likely strong association with the other two categories (depicted by horizontal arrows within box B of figure 1). Our review of the negotiation literature and our senior-practitioner interviews indicate that external conditions and constraints affect negotiations in a variety of settings (e.g., Spier [1994]; Dopuch, Ingberman, and King [1997]). In accounting negotiation, important external features are GAAP and GAAS as determined by standard setters and regulators, statutory powers of the auditor, and ethical rules developed by professional bodies. The issue may be largely defined by the presence or absence of clear standards. The interviewees were unanimous that the accounting issue was often not well defined in relation to existing standards. Unambiguous standards or clear statutory powers increase the general influence of the auditor. On the other hand, standards may be incomplete or unclear (Mason and Gibbins [1991]), making alternative treatments for specific clients or specific accounting issues difficult for the auditor to oppose. The interviewees suggested that weak or absent standards would often lead to multiple rounds of negotiation. Standards may direct the negotiation toward the size of an estimate or the degree of a disclosure. The client may wish to arrange affairs so that the letter of the standards is met, but perhaps not the spirit (e.g., "How Gillette wowed Wall Street," *Business Week* [1996]). A statutory reporting deadline or a change in standards or regulations may require a response whether or not either party wishes it, triggering a negotiation.

The parties' preferences are likely to be affected by legal, regulatory, ethical and contractual considerations that give the auditor and client management accountability to third parties such as investors, creditors and tax authorities who may rely on the financial statements (Carnaghan, Gibbins, and Ikäheimo [1996]; Gibbins and Newton [1994]; Kennedy [1993]; Koonce, Anderson, and Marchant [1995]). This means that both parties are negotiating to a degree on behalf of others' interests in addition to their own direct interests. The auditor in particular is likely to feel a professional or statutory responsibility to external parties. Negotiation research suggests accountability affects the negotiation process and outcomes (e.g., Kramer, Pommerenke, and Newton [1994]; Ben-Yoav and Pruitt [1984]).

3.3 INTERPERSONAL CONTEXT

The negotiation literature examines extensively the effects of interpersonal factors on negotiations (e.g., Moore et al. [1999]; Northcraft et al. [1998]; Ben-Yoav and Pruitt [1984]). In accounting negotiation, the financial statements and auditor's report are joint products (Dodd et al. [1984], Antle and Nalebuff [1991]) and the parties likely share legal liability risk (Palmrose [1991]), leading to potential differences from the interpersonal relationships found in the general negotiation literature. Perceived jointness of interests may arise from the auditor's wish to be re-appointed and to obtain non-auditing business with the client (Simunic [1984]), and from the client's wish to minimize the audit cost, and to use the report and statements in attracting capital and other resources (DeAngelo [1988]). Joint interests imply that both auditor and client usually prefer an unqualified audit opinion, because in the regulatory environment of accounting, any other result has severe consequences for all concerned.

The client may opinion-shop, seeking the views of other auditing firms (Salterio and Denham [1997]). The interests of the client's management may not coincide with those of the client's board of directors or audit committee (Jensen and Meckling [1976], Knapp [1987]). The audit committee, which is supposed to monitor the financial reporting process for the board, is reported to have varying degrees of effectiveness (Abdolmohammadi and Levy [1992]). Interviewees highlighted concerns about wide differences in audit committee effectiveness.

3.4 THE PARTIES' CAPABILITIES

Prior negotiation research shows that the capabilities of the parties, including the negotiation experience of the participants, influence the negotiation process and outcomes (e.g., Montgomery and Benedict [1989]; Thompson [1990]). Particular accounting factors might affect the capabilities of the parties. Client management likely knows more about its own set of financial records and economic affairs than does the auditor (Zimbleman and Waller [1999]). The auditor's knowledge and evidence gathering are constrained by audit fee restrictions, cost and the sheer size of most clients' accounting records. Auditors, even industry specialists, also vary in their degree of industry knowledge (Solomon, Shields, and Whittington [1999]). On the other hand, audit firms and their central consultation units have extensive knowledge of accounting methods and standards, and can compare the practices of a variety of clients (Salterio [1994, 1996]). Audit procedures buttress the auditor's ability to justify a position as proper (e.g., Koonce, Anderson, and Marchant [1995]; Peecher [1996]; Power [1995]). Interviewees identified two dimensions of expertise beyond negotiation expertise important to accounting negotiations: differences in auditor expertise about the client's business/industry and generally superior auditor expertise in financial accounting and reporting.

Within both the client organization and the audit firm, several people may be involved in producing accounting information and in any negotiation about it (Gibbins, Richardson, and Waterhouse [1990, 1992]). Others may be involved in the negotiation, for example, attorneys or regulators (Schuetze [1994]). Prior negotiation research indicates that teams of negotiators respond differently to accountability pressure than solo negotiators (O'Connor [1997]). Multiple participants means a potential for differences in expertise, influence and the degree to which negotiation participants perceive the auditor's and the client's interests to be aligned.

4. *Summary of Model and Research Design*

Sections 2 and 3 described the kinds of process elements and contextual features we expect to observe in the auditor-client accounting negotiation setting based on the accounting and negotiation literatures and on what we learned in the interviews with senior practitioners. Those are summarized in figure 2: Panel A lists the elements corresponding to box A of figure 1, and panel B lists the contextual features corresponding to box B of figure 1.

Guided by the framework in figure 1, our research has three main descriptive objectives: to describe the process elements, the contextual features, and the associations between the two groups (boxes A and B and arrow C of figure 1). Our research was designed to investigate the presence and importance of the elements and features, so figure 2 is also a description of our research questionnaire. Additionally, the research questionnaire collected demographic and sample characteristics data, which are listed in panel C of figure 2.

Panel A: Characteristics of accounting version of basic negotiation setting

History	*Issue*	*Process*	*Outcome*	*Next Interaction*
Effects of past issues on negotiation	Identification Accounting and disclosure implications[a] Materiality Surprise to parties	Respondents' role Duration Participants Initial Beliefs	Agreement or disagreement Audit results Other issues settled Career and personal importance	Impact on future on negotiations

Panel B: Categories of accounting features contextual in the aggregate[b,c]

Primarily external conditions	*Primarily interpersonal context*	*Primarily parties' capabilities*
Accounting and disclosure standards	Parties' desire to agree*	Audit firm's accounting expertise
Industry practices	Effects on other clients*	Audit firm's negotiation expertise
Auditing standards	Client retention	Client's accounting expertise
Securities or exchange regulations	Client service	Size of audit firm
Auditor's power to qualify	Client's inherent risk	Relative size of client
Time pressure	Past relationship with client	Parties' relative understanding of GAAP*
Reporting or filing deadline	Business reputation of client	Parties' relative understanding of client situation
Legal considerations	Dominant client CEO	Audit firm's central consultation unit
Tax considerations	Client personality characteristics	Cost of negotiation and data gathering
Owner/investor considerations	Dominant shareholder/owner	Interpersonal relationships in the audit firm
Creditor/lender considerations	Client's audit committee	
Ethical considerations		

Panel C: Demographics and sample characteristics

Respondent Demographics	*Sample Characteristics*
Job responsibilities	Reason example chosen
Years of experience	Type of audit client
Frequency of experiencing auditor-client negotiations	Recency of example
	Length of client relationship

[a] Due to confidentiality concerns expressed by partners who participated in pre-testing the questionnaire and because the issue may evolve as its implications are developed, information was gathered on the general reporting implications of the negotiated issue rather than asking for a specification of the issue.

[b] The features are organized by their primary likely nature. As they are interrelated, this is largely for expositional purposes. All features (e.g. inherent risk) are measured as perceived by respondents.

[c] Pre-tests indicated that most features listed in panel B were better asked about using importance measures and four, indicated with asterisks (*) above, were better phrased using agree/disagree measures. The resulting measures are reported in separate tables. Asterisked features are reported in results table 5; the rest are reported in table 6. See those tables for details of the measures used.

FIG. 2.—Data gathered in the field questionnaire: Characteristics of the negotiation setting, importance of contextual features, demographics and sample characteristics.

5. *The Structured Research Questionnaire*

5.1 RESEARCH OBJECTIVE

The questionnaire was designed and structured to meet the research objectives above: to describe process elements, contextual features and associations between them for real accounting negotiations as experienced by senior audit partners. The descriptions assist us in understanding and interpreting the partners' examples; they are not a census of negotiations and are not presented as descriptions of all negotiations in practice, though it may be that they do roughly outline practical experience within the limitations of the questionnaire approach used. We address some limitations such as that of retrospective recall and possible related biases in section 7 below.

5.2 QUESTIONNAIRE DESIGN

The questionnaire was initially pre-tested by four accounting Ph.D. students and an audit manager, each of whom reviewed the instrument and provided feedback, mainly on clarity. In addition, six audit partners (who did not participate in the final study) from four of the six largest public accounting firms in Canada completed the questionnaire while verbalizing factors they considered when answering the questions. Further discussion clarified their comments about the meaning and completeness of questions. This two-stage pre-test led to the final questionnaire.

To meet the field investigation objectives, the questionnaire required respondent audit partners to chose a negotiation they had experienced and describe it in depth. Gibbins and Newton [1994] use a similar approach in examining accountability in the public accounting setting as does Haskins [1987] in his study of factors affecting auditors' evaluation of client control environments. A three-sentence illustrative example of a negotiation was presented to provide the partners with a frame of reference for the term "negotiation".[1] To allow for the possibility that such negotiation does not occur, the partners were given an early exit from the questionnaire if they had never experienced accounting negotiation. No partner chose that exit.

After choosing their own negotiation example, partners were asked to state why they had chosen it and to describe the features that made it a negotiation. This first question, the only one requiring a narrative response, was used to develop the partner's recollection of the example prior to answering structured questions, which began on the questionnaire's next page.

In the main part of the questionnaire, partners answered a series of structured questions about their negotiation example. The questionnaire format and design are outlined in figure 2 with the details of question formats described in the results tables. There were several separate questions plus two sections focusing on elements and context. The questions in these two sections were presented in two separately randomized orders and results were checked for order effects. None were found. To aid in understanding the context there were descriptive questions about the chosen example

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[1] The illustrative example was: "L.H., from public accounting firm W&X, is on the way to a meeting with audit client RT Inc., to discuss an accounting issue that has arisen. The meeting is being held because the auditor and the client have different views about how to handle the issue in RT's financial statements and disclosures. L.H. has considered the process to be a negotiation, including the upcoming meeting."

(e.g., type of client) and demographic questions. The latter included how frequently the partner had experienced such negotiations, the partner's present job responsibilities, and years of experience.

5.3 ADMINISTRATION

Contacts in Canadian offices of six major international accounting firms (the "Big 5" plus a sixth international firm) were approached by phone to determine if they would be willing to participate in the study. During the phone calls, the nature of the research question was explained and details of the questionnaire were offered. All firms agreed to participate. The contacts distributed the questionnaires to experienced audit partners across the country in their firms. To improve response rates, we asked contacts to write a cover note encouraging participation and to be responsible for follow-up. To assure anonymity and confidentiality, we told the partner respondents not to identify themselves on the questionnaire and to return the completed materials to the contact person in a sealed envelope, which was sent on to us unopened.

6. *Results*

The contact people distributed 132 questionnaires in the six firms, of which 93 were returned, for a response rate of 70.5%.[2] We analyze the responses in four subsections below. First, we describe the general nature of the sample: the partners and the negotiations they chose (panel C of figure 2). Second, we report details of the three-element process model (box A of figure 1, panel A of figure 2), and third, the relative importance of the accounting contextual features (box B of figure 1, panel B of figure 2). Fourth is an analysis of the associations between the process elements and contextual features (arrow C of figure 1).

6.1 DEMOGRAPHICS AND SAMPLE CHARACTERISTICS

Table 1, Panel A presents demographic information regarding the audit partner respondents. Ninety-three percent were engagement partners, with the remainder having other partner level responsibilities. The partners were very experienced, with over two thirds having more than 20 years of public accounting experience. Sixty-seven percent reported they had experienced negotiation with 50% or more of their clients. All reported experiencing a negotiation with at least some clients. Making a "worst-case" assumption, if the non-respondents (29 of the 132 questionnaires distributed) are assumed to have not replied because they had never experienced negotiation, the 93 who had would still represent 70.5% of the sample.

Table 1, panel B describes the negotiation sample characteristics. Forty-three percent of partners reported that the negotiation related to external

[2] As the contact people collected the sealed responses before sending them on, no procedures to compare early and late responses were possible.

TABLE 1

Respondents' Job Responsibilities, Experience and Characteristics of Their Negotiation Examples[a,b]
(Sample: 93 Audit Partners from Six International Firms)

	Responses	Percent of 93
Panel A: Demographic Information About Respondents		
1. Respondent's present job responsibilities:		
Engagement partner	87	93%
Local consulting or technical partner	16	17
Managing partner	6	6
National consulting or technical partner	6	6
Other	1	1
	116	
2. Respondent's years of public accounting experience:		
10–15 years	11	12%
15–20 years	20	21
over 20 years	62	67
	93	100%
3. Frequency of respondent's experience of auditor-client accounting negotiation:		
Never experienced	0	0%
More than never but less than 50% of clients	31	33
50% of clients	15	16
More than 50% of clients but not all clients	38	41
All clients	9	10
	93	100%
Panel B: Characteristics of Respondents' Negotiation Examples		
1. Reasons respondents chose example:		
External rules and regulations involved	40	43%
Difference in auditor-client preferences	40	43
Complexity of issue	36	39
Materiality/significance of issue	30	32
Other	37	40
	183	
2. Type of audit client involved***:		
Public company	65	70%
Non-traded subsidiary of a public company	9	10
Large private company	19	20
	93	100%
3. Recency of negotiation:		
Within last 6 months	34	37%
More than 6 months but less than 1 year ago	21	22
1 to 2 years ago	22	24
More than 2 years ago	16	17
	93	100%
4. Length of client relationship:		
First year	5	5%
Second year	6	7
Third or more year	82	88
	93	100%

[a] Sample respondents are 93 audit partners (70.5% response rate) from the Canadian offices of six international accounting firms. All responses are based on actual auditor-client negotiations chosen by the respondents.

[b] The χ^2-test is used to test the null hypothesis that the response frequency for each question does not differ across firms versus the alternative that the difference is significant. Results are reported where the χ^2 test statistic is significant at the 0.05 level or lower.

*** χ^2 test statistic for firm effects significant at the 0.01 level.

rules and regulations and 43% said that differences in preferences existed between auditor and client. There was no prompting in the reasons partners gave, so it is interesting that a fundamental assumption of negotiation is represented (preference differences), as is a context feature (external standards) that appears prominently in the analysis below. Thirty-nine percent of partners noted issue complexity, which echoes the interviewees' view that issues are frequently not clearly defined, and 32% mentioned materiality or significance of the issue to the client's reporting.[3] The reported examples involved public companies (70%) and the majority occurred recently (59% less than one year previously). Most of the sample firms (88%) had been the audit firm's client for 3 or more years.

6.2 THREE-ELEMENT PROCESS MODEL

6.2.1. Issue. As reported in table 2, the issue was identified by the auditor 59% of the time. The issue(s) being negotiated had several implications, averaging nearly 4 per negotiation. The partners chose issues that were material, either in the current year alone or in both the current and future years (94%). In general, the partners reported that the issue subject to negotiation did not come as surprise, however, 32% of the time one party or the other was surprised by the issue being raised. Being surprised may be a function of (lack of) expertise and so has capability implications, an example of element-feature relationships to be explored later in the paper.

6.2.2. Negotiation Process. Table 3 contains information about the specific negotiation processes. Our mostly-engagement-partner respondents usually (88% of the time) played that role in the negotiation. Table 3 shows a large number of other people from the auditor's and client's side involved in the negotiation. There were 320 from the auditor side (93 + 227: 3.4 per negotiation) and 266 from the client side (2.86 per negotiation, nearly always including the CFO). This totals over 6 people per negotiation, on average. Few others from outside the two negotiating parties were involved. Even though the issues were virtually all material, the audit committee was involved less than half (40%) of the time. The reported negotiations tended to be lengthy: sixty-two percent lasted weeks or longer. Nearly one-half (48%) of the partners reported believing at the start of the negotiation that there was a range of mutually acceptable outcomes. An additional 37% viewed their initial role as persuading other parties that the auditor's position was the only acceptable one. This indicates that 85% of the time, a distributive solution was anticipated. Partners only rarely (14%) reported entering the negotiation looking to develop a new (integrative) solution.

6.2.3. Outcomes and Audit Results. Table 4 reports that the most common outcome (41%) of the sample negotiations was agreement on a position

[3] All results were analyzed for firm effects. Only three out of 91 response items examined showed statistically significant differences among firms. The details are noted on tables 1 and 3.

TABLE 2

Issue Identification, Implications, Materiality and Prior Knowledge[a] *(Sample: 93 Audit Partners from Six International Firms)*

1. Who identified the issue?

	Responses	Percent of 93
Client management	21	23%
Auditors, during audit	46	49
Auditors, separately from audit	9	10
Other (e.g., audit committee)	11	12
Question not answered	6	6
	93	100%

2. Accounting/disclosure implications of the issue:

	Primary implications		Secondary implications	
Implications	Responses	Percent of 93	Responses	Percent of 93
Income measurement	70	75%	12	13%
Balance sheet valuation	66	71	9	10
Footnote disclosure	33	35	30	32
Other disclosure (e.g., MD&A)	11	12	26	28
Other (e.g., tax, legal, business event)	46	49	60	64
	226		137	

3. Materiality of the issue:

	Responses	Percent of 93
Material by itself in current year	38	41%
Material by itself in current and future years	49	53
Material by itself in future years	3	3
Not material by itself	3	3
	93	100%

4. Was the issue a surprise?

	To Auditor	To client	To both	Total	Percent of 93
Yes	3	5	11	19	20%
No	6	2	55	63	68
Mixed (client surprised, not auditor: 6; auditor, not client: 5)				11	12
				93	100%

[a] See note a of table 1 for a description of the sample respondents and the statistical approach used to test for firm effects.

between the original positions of the auditor and client management. Second most common (32%) was agreement on the auditor's original position, and, consistent with the partners' initial expectations, least common (16%) was a new solution generated during the negotiations. 68% of the negotiations involved additional issue(s); half settled at the same time as the main issue and half remaining unresolved. In almost half (49%) of the negotiations, the issue(s) raised were to be considered again in subsequent years, so the agreement obtained was not necessarily stable. 96% of the clients received an unqualified opinion and the auditor was reappointed 83% of the time (not significantly different at $p > .10$ to a reappointment rate of 94% for 200 large Canadian companies reported by Byrd and Chen [1998]).

TABLE 3

Respondents' Role, Parties Involved in the Negotiation, Duration of the Chosen Examples, and Beliefs About Possible Outcomes[a] *(Sample: 93 Audit Partners from Six International Firms)*

	Responses	Percent of 93
1. Respondent's role in the negotiation:		
Manager	4	4%
Engagement partner	82	88
Consulting or technical partner or reviewer	6	7
Question not answered	1	1
	93	100%
2. Others from the audit firm involved in the negotiation:		
Staff	10	11%
Manager**	59	63
Engagement partner	23	25
Local consulting or technical partner	33	35
Managing partner	17	18
National consulting or technical partner	58	62
Others	27	29
	227	
3. Client's personnel involved in the negotiation:		
Accounting staff	52	56%
Chief financial officer	89	96
Chief executive officer	55	59
Audit committee**	37	40
Others	33	35
	226	
4. Other people involved in the negotiation:		
Others	12	13%
Other audit firm(s)	9	10
Total involved	21	
5. Duration of negotiation:		
Days or shorter	35	38%
Weeks	40	43
Months and longer	18	19
	93	100%
6. Beliefs about possible outcomes as negotiation began:		
There was a range of mutually acceptable outcomes within which agreement likely could be found	45	48%
No mutually acceptable outcomes were apparent, therefore: The auditor was prepared to work to develop a new solution that would be mutually acceptable	13	14
The auditor needed to persuade other parties that the auditor's position was the only acceptable one	34	37
Question not answered	1	1
	93	100%

[a] See note a of table 1 for a description of the sample respondents and the statistical approach used to test for firm effects.

** χ^2 test statistic for firm effects significant at the 0.05 level.

TABLE 4

Negotiation Outcomes, Disposition of Other Issues and Overall Audit Results for the Respondents' Chosen Examples[a] *(Sample: 93 Audit Partners from Six International Firms)*

	Responses	Percent of 93
1. The outcome of focal issue in this specific negotiation:		
Agreement:		
On client's original position	4	4%
On auditor's original position	30	32
Somewhere between the original positions	38	41
On a new solution generated in the negotiation	15	16
No agreement	1	1
Other outcome	3	3
Question not answered	2	2
	93	100%
2. Disposition of other issues:		
Other prior issue(s) were settled in this negotiation	19	20%
Other prior issue(s) were *not* settled in this negotiation	24	26
The negotiation raised and settled other issue(s)	20	21
The negotiation raised but did *not* settle other issue(s)	8	9
No other issue(s) involved	30	32
3. Overall audit results:		
Financial statements for that year received a clean opinion	89	96%
Audit firm was reappointed for the next year	77	83
Issue(s) were to be considered again in subsequent years	46	49
Other important consequences	21	23

[a] See note a of table 1 for a description of the sample respondents and the statistical approach used to test for firm effects.

Table 5 reports the results of a single eight-part question.[4] These results are described where applicable below. To finish the outcome descriptions, panel A of the table shows that two thirds of the respondents thought the negotiation was important to them personally but there was no consensus about whether the negotiation was important to their careers.

6.2.4. Auditor-Client History and Next Interaction. In figure 1 there are two boxes outside the three process elements: history and next interaction. Results above showed that the partners went into the negotiation with expectations about it, and that many issues were expected to come up again in the future. We posed two direct questions about past issues and later negotiations. Table 5, panel A shows that there was little agreement on whether past issues affected the outcome of this negotiation. Over 50% of respondents

[4] Partners' reasons for choosing the example were independently coded by one of the coauthors and a research assistant. Initially, 215 items were coded to the five reasons reflected in table 1; the coders agreeing on 152 (71%) of these items. The coders met to review and resolve the 63 coding differences. This resulted in adding 31 items to the 152, producing the 183 items in table 1, and discarding 32 that were agreed not to be clearly distinguishable as reasons.

TABLE 5

Respondents' Relative Agreement with Statements Related to the Basic Accounting Setting and Contextual Accounting Features of Their Chosen Negotiation Examples[a,b]
(Sample: 93 Audit Partners from Six International Firms)

	"Agreement" Frequencies[c]					Overall		
	Disagree			Agree				
	Entirely/ Strongly	Mildly	Neutral	Mildly	Entirely/ Strongly	Mode	Mean	Std. Dev.
Panel A: Basic Accounting Setting								
Accounting Outcome								
1. The negotiation or outcome was important to my career	33	10	20	21	8	5	3.46	1.70
2. The negotiation or outcome was important to me personally	9	4	18	25	36	5	4.90	1.35
Auditor Client History and Next Interaction								
3. Resolution of past issues affected the outcome of this negotiation	27	8	14	25	18	5	3.90	1.58
4. The outcome of this negotiation affected later negotiations with this client	19	6	14	27	24	5	4.37	1.75
Panel B: Contextual Accounting Features								
Interpersonal Context								
1. Both auditor and client wanted to reach an agreement on the issue(s)	4	3	2	7	76	6	5.93	1.31
2. The outcome of this negotiation affected the auditor's relations with other clients	52	9	18	8	5	1	2.61	1.66
Parties' Capabilities								
3. The auditor had a better understanding of GAAP than the client did	8	1	5	22	56	6	5.50	1.47
4. The client initially understood their situation better than the auditor did	47	19	12	8	6	2	2.81	1.55

[a] See note a of table 1 for a description of the sample respondents.

[b] Multivariate analysis of variance (MANOVA) is used to test the null hypothesis that the responses for the set of 8 items do not differ across firms versus the alternative that the difference is significant. The difference is not significant (Wilk's $\lambda = .671$ $p = 0.44$).

[c] Respondents rated their agreement to each statement on a 7-point scale labeled "Entirely Disagree," "Strongly Disagree," "Mildly Disagree," "Neutral," "Mildly Agree," "Strongly Agree" and "Entirely Agree." Those points are designated 1, 2, 3, 4, 5, 6, and 7 for purposes of reporting the mode. Total number of responses is less than 93 for each item because of missing data.

agreed that the negotiation outcome would affect later negotiations with this client.[5]

6.3 ACCOUNTING CONTEXTUAL FEATURES

All but four of the accounting contextual features proposed in panel B of figure 2 were measured in one question that required respondents to rate the importance of each of 29 contextual features (scale details provided in table 6).[6] Given the large number of features suggested in figure 2, we chose to have partners rate the importance of each rather than attempt to rank them (see Haskins [1987] for a similar scale and rating approach). The other four features were part of the relative agreement question reported in table 5, panel B.

For the 29 features, we first tested whether the reported means were significantly different from no importance (1 = None). Each mean is significantly different from 1 ($p < 0.05$) employing both parametric and non-parametric statistics adjusted for multiple comparisons. Thus, all the accounting contextual features suggested in the discussion leading to figure 2 had at least some degree of importance in the negotiation examples.

As shown in table 6, every feature, except tax considerations and client size relative to audit firm size, was reported as "essential" in at least one negotiation example. Every feature was also reported to have no importance to at least one negotiation. The varying roles of these features provide preliminary support to the idea that the features contextualize each negotiation.

The response frequencies in table 6 also suggest that some features are consistently rated as important or unimportant across many of the respondents' examples, while the importance of other features varies across the settings. We identified such features by a two-part procedure: (1) is the feature identified by more (or less) than 50% of the partners as being above (or below) the middle moderate rating of 3, and (2) is the feature's rating significantly higher (or lower) than 3 (using both parametric t tests and non-parametric sign and sign rank tests adjusted for multiple comparisons, $p > .05$).[8] With these criteria, two features (bolded in table 6) were

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[5] To test for a random response pattern, we computed Kendall's non-parametric coefficient of concordance (W). Kendall's W is a measure of the degree of agreement among respondents (Daniel [1990]). For this question, $W = .450$ ($p < .0005$), indicating the response pattern was not random.

[6] Neither of these items is significantly different from the neutral position employing parametric (t-test) and non-parametric (sign and sign rank test) statistics.

[7] To test for a random response pattern in this question, Kendall's non-parametric coefficient of concordance (W) was again calculated. For the 29 items, $W = .207$ ($p < .0005$) indicating the response patterns are non-random. In addition, in section 6.4 we examine response patterns in more detail, providing further evidence that the patterns are not random.

[8] We checked the sensitivity of our two-part test by using a 40% cut-off and a 60% cut-off. The only change to the results shown in table 6 is that "Reporting or filing deadline" is no longer consistently unimportant using a 60% criterion.

important across many negotiations and eight (italicized) were unimportant. The former are accounting and disclosure standards and the audit firm's accounting expertise. The latter are deadlines, creditor, legal and tax considerations, client retention, cost of negotiation, size of the audit firm, and relative size of auditor and client. Table 5, panel B adds to this picture: Partners agreed strongly that both auditor and client wanted to reach agreement, and that most did not think the outcome of this negotiation would

TABLE 6

Respondents' Rating of the Importance of 29 Accounting Contextual Features to Their Chosen Negotiation Example and Its Outcome[a,b] *(Sample: 93 Audit Partners from Six International Firms)*

	"Importance" Frequencies[c]					Overall		
	None	Low	Moderate	High	Essential	Mode	Mean	Std. Dev
External Conditions and Constraints								
1. Accounting and disclosure standards[d]	**1**	**3**	**11**	**53**	**24**	**4**	**4.04**	**.78**
2. Owner/investor considerations	14	15	14	36	13	4	3.21	1.30
3. Industry practices	15	17	14	32	13	4	3.12	1.33
4. Securities or exchange regulations	25	5	20	25	17	1 & 4	3.04	1.47
5. Auditing standards	16	16	21	27	12	4	3.03	1.30
6. Auditor's power to qualify audit report	6	35	27	14	10	2	2.86	1.10
7. Time pressure	11	28	29	20	4	3	2.76	1.06
8. Ethical considerations	18	25	23	18	8	2	2.71	1.24
9. Reporting or filing deadline[e]	*20*	*26*	*28*	*10*	*7*	*3*	*2.54*	*1.18*
10. Creditor/lender considerations	*25*	*35*	*11*	*12*	*9*	*2*	*2.40*	*1.28*
11. Legal considerations	*29*	*29*	*16*	*11*	*7*	*1*	*2.33*	*1.25*
12. Tax considerations	*46*	*36*	*6*	*4*	*0*	*1*	*1.65*	*.79*
Interpersonal Context								
13. Client's inherent risk	6	19	24	32	10	4	3.23	1.11
14. Past relationship with the client	8	11	33	39	1	4	3.15	.96
15. Business reputation of client management	6	26	27	31	2	4	2.97	.99
16. Dominant client CEO	8	28	28	18	10	2 & 3	2.93	1.14
17. Client service considerations	13	17	33	27	2	3	2.87	1.06
18. Other client personality characteristics	11	27	21	30	1	4	2.81	1.07
19. Dominant shareholder/owner	23	24	18	16	11	2	2.65	1.35
20. Client's audit committee	21	23	22	20	5	2	2.61	1.22
21. Client retention	*19*	*36*	*19*	*15*	*3*	*2*	*2.42*	*1.09*
Parties' Capabilities								
22. Audit firm's accounting expertise	**6**	**7**	**19**	**46**	**14**	**4**	**3.60**	**1.05**

TABLE 6—*Continued*

	"Importance" Frequencies[c]					Overall		
	None	Low	Moderate	High	Essential	Mode	Mean	Std. Dev
23. Audit firm's negotiation expertise	6	13	38	32	3	3	3.14	.93
24. Client's accounting expertise	7	23	30	31	1	4	2.96	.97
25. Interpersonal relationships in the audit firm	14	25	20	28	5	4	2.84	1.18
26. Audit firm's central consultation unit	18	22	25	21	6	3	2.73	1.20
27. Size of the audit firm	*43*	*25*	*14*	*8*	*2*	*1*	*1.92*	*1.08*
28. Size of the client relative to the audit firm	*37*	*33*	*17*	*5*	*0*	*1*	*1.89*	*.89*
29. Cost of negotiation and data gathering	*38*	*36*	*15*	*2*	*1*	*1*	*1.82*	*.86*

[a] See note a of table 1 for a description of the sample respondents.
[b] Multivariate analysis of variance (MANOVA) is used to test the null hypothesis that the responses for the set of 29 items do not differ across firms versus the alternative that the difference is significant. The difference is not significant (Wilk's $\lambda = .163$ $p = 0.35$).
[c] In each category, responses are in order of mean importance. Respondents rated the importance of each item to their chosen negotiation example on a 5-point scale with points None, Low, Moderate, High, and Essential. Those points are designated 1, 2, 3, 4, and 5 for purposes of reporting the mode. Total number of responses is less than 93 for each item because of missing data.
[d] Features in bold are significantly ($p = 0.05$ or lower) above the scale mid-point (3) and reported as "high/essential" by more than 50% of respondents. Both parametric (simple t-tests) and non-parametric (Wilcoxon signed rank test and sign test) statistical tests were employed (adjusted for multiple comparisons) and the results do not differ qualitatively.
[e] Features in italics are significantly ($p = 0.05$) below the scale mid-point (3) and reported as "low/none" by more than 50% of respondents. Both parametric (simple t-tests) and non-parametric (Wilcoxon signed rank test and sign test) statistical tests were employed (adjusted for multiple comparisons) and the results do not differ qualitatively.

affect their relationships with other clients.[9] The partners saw themselves or their firm as having an expertise advantage: Table 5, panel B reports that nearly 85% agreed that they had a better understanding of GAAP than the client did and 72% disagreed with the statement that the client understood their situation better than the auditor did.[10]

6.4 ASSOCIATIONS BETWEEN PROCESS ELEMENTS AND CONTEXTUAL FEATURES

We now turn to arrow C of figure 1, the associations between the process model elements and the contextual features, which were mostly not

[9] Using statistical tests analogous to the tests employed on the 29 features in table 6, the two findings from table 5 are significantly different from the neutral position (denoted as "4") at the p-value of 0.05, employing parametric (t-test) and non-parametric (sign and sign rank tests) tests.
[10] Both of these items are significantly ($p < .05$) different from the neutral position (denoted as "4").

consistently important or unimportant across the negotiation examples. Such associations are central to the contextualized model proposed in figure 1 and used to structure the questionnaire. We investigate the associations in two steps: first, the overall association of the pattern of contextual features with the process elements, and second, the individual associations.

6.4.1. Overall Association Between Contextual Features and Negotiation Process Elements. There are numerous variables in this study, so we begin with an investigation of overall association. If that does not exist, individual associations may be coincidental. Overall association is examined using multivariate ANOVAs (MANOVAs) or multivariate multiple regression analyses. We test whether the process model element measures are associated with the overall patterns of accounting contextual feature importance. Each measure of issue, process or outcome is treated as an independent variable and the set of 29 accounting contextual features as the dependent variable.[11] This provides a measure of association between the former and the latter *as a set* and incorporates the correlations among the 29 items into the test statistic (Stevens [1996]). We do not imply any direction to the association by our use of this analysis.

The multivariate analysis matched each process element measure with the same pattern of context features shown in table 6. The element measures were taken from tables 2, 3, and 4, and panel A of table 5. Not all the measures in those tables were used in the multivariate analysis, usually because there was not enough variation in some measures to make the analysis feasible, but also because some (such as the accounting/disclosure implications in table 2) were descriptively complex and did not lend themselves to a one-dimensional categorization. The element measures and the result for each are set out in table 7. (The measures of national office involvement within the firm and of audit committee involvement within the client were included based on Salterio and Denham [1997] and Abdolmohammadi and Levy [1992], indicating such involvement for difficult situations.) Most of the measures were significantly associated with the features pattern, so there was an overall association in the partners' example negotiations.[12]

6.4.2. Individual Associations Between Contextual Features and Negotiation Process Elements. We now review the individual associations within the overall patterns shown above. Table 8 shows the significances of individual ANOVAs and regressions between those elements shown in table 7 to be significantly

[11] Scale differences prevented us from including the four context items reported in table 5, panel B.

[12] Analysis can also be done on the history and subsequent interaction boxes of figure 1. Table 5, panel A reports on the effects of the resolution of past issues on this negotiation outcome and the effects of this issue on later negotiations with the same client. Both of these variables were marginally significantly associated with differences in the overall pattern of importance ratings for the 29 contextual features (Wilk's $\lambda = 0.534$, $p < 0.06$ and Wilk's $\lambda = 0.546$, $p < 0.06$).

TABLE 7

Multivariate Tests of Association Between Selected Issue, Process and Outcome Elements and the Overall Pattern of the 29 Accounting Contextual Features[a,b] *(Sample: 93 Audit Partners from Six International Firms)*

Negotiation Process Element	Table/Item[c]	Wilk's λ	F-Stat
Issue			
Who identified issue (client, auditor or other)[d]	2/1	0.288	1.49**
Who (auditor or client) was/was not surprised[d]	2/4	0.511	1.81**
Process			
Total number of audit personnel involved[e]	3/2	0.588	1.37
National consulting or technical partner involved[d]	3/2	0.459	2.32***
Total number of client personnel involved[e]	3/3	0.515	1.85**
Audit committee involvement[d]	3/3	0.497	1.99**
Duration of the negotiation[d]	3/5	0.302	1.58**
Beliefs about possible outcomes[d]	3/6	0.426	1.01
Outcome and Next Interaction			
Whose position was taken in the final agreement[d]	4/1	0.312	1.25
Consider issue again in subsequent years[d]	4/3	0.487	1.63*
Career importance of negotiation to partner[e]	5/1	0.535	1.71**
Personal importance of negotiation to partner[e]	5/2	0.557	1.56*

[a] Not all negotiation process elements reported in tables 2–4 are included in these analyses because of the lack of variation in some measures ("issue materiality," "respondent's role," "other people involved in the negotiation," and "overall audit results") and the descriptive complexity of others ("accounting/disclosure implications of the issue," and "disposition of other issues").

[b] Multivariate analysis of variance (MANOVA) or multivariate regression analysis is used to test the null hypothesis that the negotiation process element is not associated with the set of 29 accounting contextual features versus the alternative that the association is significant. Each negotiation process element is treated as the independent variable in the analysis and the set of 29 accounting contextual features is the dependent variable.

[c] "Table" refers to the table in which the negotiation process element is reported and "Item" refers to the specific item within the table.

[d] MANOVA is used to test the significance of the association with the negotiation process element as the categorical independent variable. The categories used in each MANOVA are consistent with those reported in tables 2–4 with two exceptions. For "Who identified issue" the two auditor categories ("during audit" and "separately from audit") are combined. For "Whose position was taken in the final agreement" three categories are used: "on client's original position," "on auditor's original position," and "somewhere between the original positions." The remaining categories have too few responses to be included in the analysis.

[e] Multivariate regression is used to test the significance of the association. For both "Total number of audit personnel involved" and "Total number of client personnel involved" the independent variable is the total number of participants for each respondent's example. For "Career importance of negotiation to partner" and "Personal importance of negotiation to partner" the independent variable is the respondent's level of agreement to each statement measured on a 7-point scale (see table 5 for a description of the scale).

Significance of the F-statistics for the multivariate analyses: ***$p < 0.01$, **$p < 0.05$, and *$p < 0.10$.

related to the pattern of all 29 features and the individual features. The features are shown in order of their importance ratings (from table 6) within each of the categories used in figures 1 and 2. Only those univariate associations that are at least marginally significant ($p < 0.10$ two sided) are indicated in table 8.

Table 8 reveals several results. First, the existence of so many associations indicates that the reported negotiation processes varied with context and supports the contextualized framework set out in figures 1 and 2. Second, some of the features that appeared from table 6 to have little importance in most negotiations were associated with elements of the process, so although they were not important to many negotiations, when present they

TABLE 8

Univariate Tests of Associations Between the 29 Individual Accounting Contextual Features and Selected Issue, Process, and Outcome Elements[a,b] *(Sample: 93 Audit Partners from Six International Firms)*

	Negotiation Elements								
	Issue		Process				Outcome		
Accounting contextual features in order of importance (see table 6)	Who identified	Surprise	National Office	Involvement Number of Client	Parties Involved Audit Committee	Involvement Duration	Issue considered again	Career Importance	Personal Importance
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
External Conditions and Constraints									
1. Accounting and disclosure standards						*			
2. Owner/invester considerations									**
3. Industry practices						***			**
4. Securities or exchange regulations				*				*	
5. Auditing standards	*						***	**	
6. Auditor's power to qualify audit report								***	
7. Time pressure	**	**	**		**			**	
8. Ethical considerations				**		***		***	***
9. Reporting or filing deadline	**			**				*	
10. Creditor/lender considerations	**			**		**			
11. Legal considerations	**			*		**	**	***	
12. Tax considerations				**				*	
Interpersonal Context									
13. Client's inherent risk	***					***	**	***	
14. Past relationship with the client									**
15. Business reputation of client mgmt	*			**					
16. Dominant client CEO		**							**
17. Client service considerations	**	*	**	***		*			
18. Other client personality characteristics								***	***
19. Dominant shareholder/owner								**	**
20. Client's audit committee				***	***				
21. Client retention	**				*			**	***
Parties' Capabilities									
22. Audit firm's accounting expertise			*						
23. Audit firm's negotiation expertise			*					**	
24. Client's accounting expertise		*		*					
25. Interpersonal relationships in audit firm	*	**	*	**					**
26. Audit firm's central consulation unit	**		***	*		***		*	
27. Size of the audit firm	*			**	*			**	**
28. Size of client relative to audit firm								**	
29. Cost of negotiation and data gathering	***	***		**		***			
Overall degree of association for 29 features[c]	**	**	***	**	**	**	*	**	*

[a] Only those negotiation process elements found to be significantly associated with the set of 29 accounting contextual features per table 7 are analyzed further in table 8.

[b] Univariate analysis of variance (ANOVA) or univariate regression analysis is used to test the null hypothesis that the negotiation process element is not associated with each of the 29 accounting contextual features versus the alternative that the association is significant. The negotiation process element is the independent variable and the accounting contextual feature is the dependent variable. Associations tested using MANOVAs in table 7 are tested using ANOVAs in table 8 and associations tested using multivariate regression in table 7 are tested using univariate regression in table 8. See note d and note e of table 7 for a description of the independent variable measures used in the analyses.

[c] Results of multivariate tests of association reported in table 7.

Significance of the F-statistics for the univariate analyses: $^{***}p < 0.01$, $^{**}p < 0.05$, and $^{*}p < 0.10$.

interacted with some of the partners' sample of negotiations. Such features include creditor, legal, and tax considerations, client retention, and cost of negotiation. Third, there is little association of the two features shown earlier to be most consistently important to many negotiations: accounting and disclosure standards, and audit firm's accounting expertise. We do not have an explanation for this: Perhaps there was not enough variation in the high importance ratings to provide associations. Fourth, numerous associations with process elements suggest interesting connections. Some of these are the frequently strong associations with client inherent risk, the cost of negotiation, and ethical considerations. Pervasive, but less strong, associations exist with process elements and time pressure, client service considerations, client retention, legal considerations, interpersonal relationships in the audit firm, and size of the audit firm. Fifth, all features appear at least once in table 8, and all elements have several associations with context.

7. *Discussion and Conclusions: Results and Research Implications*

This paper presents a three-element process model of auditor-client accounting negotiation with a tentative set of associated accounting contextual features. The results of our field questionnaire are broadly consistent with our framework. The framework informed the data gathering, so the data corroborate it but do not constitute an empirical test of it. We based the model on the general negotiation literature, the limited accounting/auditing research having implications for negotiation, and qualitative interviews with senior practitioners. This final section discusses the results and outlines some implications for further modeling and empirical research on auditor-client accounting negotiation. We also point out some limitations in our conceptualization of the topic and in the portrayal obtained from the questionnaire.

7.1 RESULTS DISCUSSION

The partners' sample negotiations were recent, important to the partners personally but not so much to their careers, were with continuing largely public-company clients, and involved differences with those clients that were material to the financial statements and frequently arose from external standards. We summarize the findings from this negotiation sample as follows.

Accounting negotiation is context-dependent. In this initial exploration of auditor-client accounting negotiation, we suggested that the basic negotiation model had to be put in the accounting context because that context would define and guide the negotiation. Our results show much context dependence, both as to all the elements of the negotiation process and their associations with the set of context features we presented to the partners. Every context feature was associated with some element of the process experienced by at least some partners. Our questionnaire did not extend to every possible aspect of the accounting context, so context may even be more pervasive than in our results. Our finding of contextual association connects the two parts of the conceptual framework in figure 1 and so ties that framework together.

Accounting negotiation is normal. The partners were familiar with negotiation. The issue was rarely a surprise, the outcome was nearly always agreement, and the auditor was usually reappointed. Consistent with this positive setting, client retention and cost of negotiating were not rated as important, nor were creditor, legal or tax implications. These context features were associated with process elements however, so they appeared to matter in some cases.

Accounting negotiation issues are complex. Negotiation may be about a central issue or a variety of issues, some being brought in if an integrative solution is sought. The partners identified several accounting or disclosure implications, usually income measurement and balance sheet valuation plus a variety of other primary and secondary implications. Issues other than the focal one were usually involved and about half the time settled in the negotiation. Also about half the time, the partners expected the negotiated issue to be considered again in later years and the negotiation to affect later negotiations with the client.

Accounting negotiations take much time and several people. The partners reported that several audit firm and client people were involved, and that the negotiation usually took at least weeks. The audit firm's national office technical support played an important role, and interpersonal relationships in the audit firm were associated with several process elements. The client's audit committee was only occasionally important, and people outside the two parties were seldom involved. The CFO was almost always involved. This is consistent with negotiation being a regular if not routine part of producing the client's financial statements.

Auditor expertise is central to accounting negotiation. The issue was seldom a surprise, and the partners saw the auditor (rather than the client) as having identified the issue most of the time. Generally the partners saw the auditor as having an expertise edge, as to GAAP and even understanding the client's own situation better than the client did. The partners saw external standards as pervasively important and other external factors as important, and saw the needed expertise to be technical more than in conducting negotiation.

Accounting negotiation is distributive. Consistent with the general negotiation literature, the partners anticipated distributive solutions rather than integrative ones, and reported outcomes in line with their expectations. Generating new solutions might be costly; perhaps the partners did not see the cost of negotiation as important because they did not see much need to generate new solutions. This is part of seeing accounting negotiation as normal. It may also reflect the partners' view of their roles as finding an acceptable solution within a known range of solutions, even to trying to impose their own position. Negotiation was not viewed as particularly creative.

Accounting negotiation is part of client service. The partners viewed their role as helping to produce appropriate financial statements. Accounting negotiation is part of a stream of relations with the client, and dealing with it is associated with client service considerations, client retention, legal considerations and other complexities. The partners were aware of the client's circumstances, especially inherent risk, but seemed to see negotiation as part of serving the client rather than as an antagonistic process. They recognized that negotiation implied an initial disagreement, but felt they and their firms had the expertise to reach an acceptable outcome and that the parties usually had a mutual desire to reach agreement.

7.2 RESEARCH IMPLICATIONS

Besides presenting initial descriptive evidence, our research objective is to provide a basis for further modeling and empirical research in accounting negotiation. Our results indicate that such negotiation occurs in a complex context consisting of external standards, multiple issues, and numerous people acting over an extended time. Factors such as the auditor's relative expertise and client service considerations are important to the process and outcomes.

Some specific negotiation aspects appear particularly promising for more systematic investigation. These include: the pervasive role of accounting; disclosure and other external standards; the level of auditor expertise (both absolutely and in comparison to the client); the role of negotiation expertise; interpersonal relationships within the audit firm and with the client; who identifies the issue and what negotiation edge is thereby provided; and separating negotiation's personal and career importance to the auditor. Further elaboration of the contextual features we considered would be useful, taking into account that some appear generally important and some do not, but also that all appear to have a role in some negotiations. Our design did not allow us to determine why features took on the importance or lack of it that they did, nor to determine why external accounting standards were seen by the partners as pervasively important but not associated particularly with any element of the negotiation process.

We investigated features that the basic negotiation literature and our initial interviews suggested would be important, but some of these did not seem important in our sample (though several were important to some negotiations). These included reporting deadlines, cost of negotiation, size of audit firm and size of client relative to audit firm (the latter two being common proxies for power). Two other non-significant results also bear further research consideration. We found no association between the reported initial beliefs of the parties and the contextual features, yet beliefs are considered very important in basic negotiation models. We also found no association between the final issue outcome (e.g., agreement on auditor's initial position) and the overall pattern of the 29 contextual features proposed.

As our results were as reported by the audit partners, future research might focus on client management's perceptions of the key factors affecting negotiations with auditors. The only evidence available (Beattie, Brandt, and Fearnley [2000]) suggests that client management and auditors in the

United Kingdom have a high degree of agreement on what types of topics (e.g., financial reporting, disclosure, fees) they negotiate. That research does not address the more detailed aspects of the negotiation context that we investigate in this paper, so investigating these aspects from the other side of the negotiation would be useful.

A context-sensitive model is clearly needed to support more rigorous investigation. The model should incorporate both pervasive aspects (such as issue complexity, the participation of several people, the role of external standards and changes in them, and expectation of distributive bargaining) and aspects important to particular negotiations or elements of the negotiation process (such as cost, time pressure, client inherent risk and the audit committee). The role of accounting expertise in negotiation might be modeled more fully, including differential expertise, the expertise of various members of the groups on both the auditor's and the client's sides, and expertise-related features such as information asymmetries and information flows during the negotiation.

Our investigation did not follow a negotiation in process. An empirical study or model could give attention to the negotiation's time line from initial trigger to final resolution, parties' acceptable ranges of outcomes, the bargaining strategy adopted by both sides, and choices to stay in or leave the process made by both sides as the negotiation proceeds. While we have made the case that accounting negotiation significantly affects the content of financial statements released to users, we have not investigated the degree to which different accounting issues offer different joint interests, strategies and constraints. Empirical financial accounting studies of accounting choice, cash flow versus accrual measures and prediction suggest that accounting issues do differ on a number of dimensions that could affect the negotiation process we have outlined.

7.3 LIMITATIONS

One limitation we noted above is that although negotiation involves at least two parties, this paper has focused only on the auditor's side of the story. Our earlier interviews included some practitioners from industry, but the questionnaire respondents were all audit partners. In understanding the auditor's view, we also acknowledge that the auditor's responses were based on memory for events some of which happened as long as three years ago. While our pretest showed that auditors had no difficulty in recalling these events, biased recalls may affect the reported results.

Asking partners to select their own examples may have biased the responses toward negotiations where outcomes were satisfactory to the respondents. Our analysis contains little about negotiation failure or breakdown. The influence of individual contextual features may differ for satisfactory and unsatisfactory negotiations, which would reduce the descriptive generalizability of our findings. However, unless entirely different features are present in such cases, any such bias would not diminish the validity of the results in identifying the set of features operating in the accounting negotiation setting, particularly if it is common.

Our analysis focused on developing evidence related to the figure 1 conceptualization and accepted the possibility of response biases in order to have the partners define and choose their negotiation examples. There was room for response bias in questions such as those on the personal and career importance of the negotiation, and the partners may have put themselves more front-and-center than others would have seen them.

A further limitation is that this paper's analysis has not delved into such potentially important and likely context-sensitive factors as bargaining strategy, first mover advantage or information developed and/or transmitted during negotiation. We have considered the auditor to be a full negotiator, with self-interest and an opportunity to "win" or "lose." Other views of the auditor's role might be investigated, such as to posit the auditor as an arbitrator or as acting on behalf of others.

Last, in our exploratory investigation of accounting negotiation, we sought to outline the nature of this under-studied phenomenon and did not attempt to conduct tests of theory or to construct detailed ecological descriptions. Further study can do both.

7.4 CONCLUSION

This paper shows that auditor-client accounting negotiation occurs on a regular basis and involves a complex set of context sensitive features. We identify a large number of dimensions of accounting negotiation, and hope the ideas in this paper will stimulate much more research into this interesting and provocative part of the production of financial accounting information.

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