Study Says Auditors' Bias Toward Clients Often Goes Unchecked (March 5, 2015)

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Today's News

Audit Practice News

Study Says Auditors' Bias Toward Clients Often Goes Unchecked

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Summary: *A recent academic study found that when engagement reviewers know that an auditor in the field has a personal bias in favor of or against certain clients, they often reinforce the field auditor's decisions. Reviewers who aren't aware of the field auditor's feelings are more likely to override decisions made in the field, the researchers found.*

Engagement reviewers who are aware of "affective bias" of field auditors toward clients relied more than they should have on the auditors' judgments, according to a recently published academic study.

The research defines "affective bias" as the field auditor's personal like or dislike of the client.

Previous studies have shown that auditors who have about three years of experience become biased when they like or don't like the client. Conventional wisdom says that auditors who are aware of the feelings will guard against being influenced in issuing an audit opinion.

But Vicky Hoffman, a business professor at the University of Pittsburgh and doctoral candidate Michele Frank, found that instead of discounting the auditor's judgments, the reviewers rely more on the audit team's conclusions than they would if they didn't know about the bias. The study appears in the March/April 2015 issue of the American Accounting Association's *Accounting Review*.

"Reviewers who are not informed about the preparer's affect are not significantly influenced by the preparer's judgment and arrive at judgments more consistent with the audit evidence," the study noted. "In contrast, reviewers who receive the same preparer judgment and workpaper evidence, but who are also informed of the preparer's affect, are significantly influenced by the preparer's judgment."

The behavior is called "ironic rebound effect" to describe when professionals are swayed by judgments of colleagues with a personal bias.

Hoffman, who was a senior auditor with Coopers & Lybrand in Washington before it merged with Price Waterhouse, says the findings have important implications for practicing auditors in the field.

"Partners often visit audit staff on client engagements, taking them to lunch or interacting with them in other informal social settings," the study says. "It is not unusual for preparers with relatively strong personal feelings toward the clients' personnel to discuss them with the rest of the audit team."

The researchers set up an online experiment with 119 audit managers and senior managers from two Big Four accounting firms who had an average of 9.37 years of experience.

They were presented with information about an electronic components maker whose primary competitor has developed a prototype of a technically advanced component that sells for about 20 percent less than competing products. The company was described as having a competent management. Its auditor had issued unqualified opinions in each of the last five years.

The test participants were asked to take the role of an engagement reviewer and look at the audit team's judgments about the client's inventory.

The audit team reached a very favorable conclusion for the client that no writedown of inventory is required in half of the cases. The other half of the cases produced an unfavorable recommendation of a $1.2 million writedown.

Half of the engagement reviewers of the favorable recommendations were informed that the lead partner in the audit team mentioned having previously worked with the client's controller at a different company and really liked him. Half the reviewers of the unfavorable conclusion were informed that the lead partner in the audit team had an unhappy experience at another firm with the controller, whom he found arrogant, condescending, and unpleasant.

The remaining subjects were given no information about personal likes or dislikes.

The study found that engagement reviewers' judgments were swayed by whether the field auditor liked or disliked the controller.

Among those who reviewed judgments favorable to the client, those who were informed that the controller was very pleasant urged an average writedown of $42,000, which was only about one third the $119,200 suggested by those who were told nothing of personal relationships. With the reviews of judgments unfavorable to the client, reviewers with no knowledge of the personal dislike recommended an average writedown of $183,103, while the reviewers who were told that the controller was extremely unpleasant called for an average writedown of $357,333.

The study said it's highly unlikely that the reviewers were naïve about the audit team's potential to be unduly influenced by their feelings towards clients.

According to behavioral researchers, people who try to ignore or minimize biased judgments undergo a subconscious monitoring process to alert them how much to discount such bias. The monitoring process intensifies, which keeps the information prominent and increases its effect on the final decision.

The monitoring process's effect on reviewers may be increased by "secondhand affective reactions, which are subconsciously positive toward client personnel that the preparer likes and negative toward those that the preparer dislikes," the study says.

The accounting firms are aware that people have psychological biases, and Hoffman's research may add another dimension to the awareness, although it's not clear that auditors will begin to change their behavior because of it.

"It's not so obvious how you are going to get rid of the psychological bias," Hoffman said.

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