

THE EFFECTS OF AUDITING EXPERIENCE ON SENSITIVITY TO ETHICAL AND TECHNICAL ISSUES

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This research examines the effects of public accounting experience on the ability to recognize ethical and technical issues presented in an audit planning context. Auditing students, staff auditors, and audit seniors completed an experimental case that required them to identify issues and rate the perceived significance of each issue identified. As hypothesized, experienced auditors identified significantly more technical issues and significantly fewer ethical issues than did auditing students. In addition, experienced auditors identified significantly more issues that were considered administrative in nature. Various individual difference variables such as ethical ideology and gender were not predictive of performance on the experimental task.

The results of this study suggest that, while public accounting experience enhances the ability to recognize technical auditing and accounting issues, it does not result in a similar improvement in ethical sensitivity. The findings also raise concerns about the ethical sensitivity of young professionals.

Ethics and morality among professional auditors have been receiving a great deal of attention in the academic literature (e.g., Ponemon, 1990; 1992; Gaa, 1992; Lampe and Finn, 1992; Shaub, 1993). However, extant empirical work in this area has primarily focused on auditors' level of moral development or ability to make moral judgments, with limited attention being given to other components of moral behavior such as the ability to recognize situations that

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require moral judgments (Shaub et al. 1993). Similarly, much research has investigated auditors' technical expertise and the effects of professional auditing experience on such expertise, but little attention has been given to auditors' ability to recognize technical auditing or accounting issues.

This study extends previous research by investigating professional auditors' and auditing students' sensitivity to ethical and technical issues in an audit planning context. The study makes two primary contributions to the auditing literature. First, it provides evidence regarding the effects of the public accounting environment on sensitivity to several significant ethical issues faced by professional auditors. Second, it extends existing knowledge of the effects of auditing experience on technical expertise to a practically significant but previously unexamined task.

The remainder of the paper proceeds as follows. The next section contains a review of the relevant literature and development of research hypotheses. The third section discusses the experimental task and subjects. The empirical results are then discussed in detail. The final section of the paper presents conclusions and implications of the research.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Sensitivity to Ethical Issues

Empirical research on auditing ethics has been heavily influenced by the psychological theory of moral judgment developed by Kohlberg (1969, 1984) and Rest (1979, 1986a). According to this theory, there are four components of moral behavior: (1) the ability to recognize situations that require moral judgments, i.e., ethical sensitivity, (2) the ability to make moral judgments regarding the appropriate course of action, (3) commitment to morally appropriate action, and (4) the ability to follow through on this commitment (Rest, 1986a). Most tests of the Kohlberg/Rest theory in auditing contexts have focused on the second component of moral behavior, the ability to make moral judgments.

The first component of moral behavior, ethical sensitivity, has received relatively little research attention. However, the ability to recognize situations that require moral judgments is a significant component of the ethical decision-making process. As observed by Jones (1991) and Shaub et al. (1993), if the ethical implications of a situation are not recognized, the appropriate rules for addressing these implications will not be activated. Thus, ethical sensitivity may be viewed as a prerequisite for making appropriate ethical judgments.

Ethical sensitivity appears to be particularly significant in the public accounting environment. As observed by the managing partners of the then Big eight firms, "Practitioners must ... be able to identify ethical issues and apply a value-based reasoning system to ethical

questions" (Arthur Andersen & Co. et al. 1989, foreword). Rules for resolving the majority of ethical issues encountered by public accounting practitioners are set forth in professional codes of conduct (Finn et al. 1988). Thus, if auditors fail to recognize situations to which these rules potentially apply, they run the risk of violating explicit provisions of their professional standards without realizing they are doing so. Because compliance with professional standards is considered the minimum acceptable level of conduct by CPAs (Lampe and Finn, 1992; Epstein and Spalding, 1993), the implications for the reputation of the profession of failing to recognize the applicability of these standards to common ethical situations are apparent.

Due to the significance of ethical sensitivity in the public accounting environment, there is a need for an understanding of its determinants. Although relatively little evidence is available on this issue, studies in the social psychology literature suggest that contextual or situational factors appear to influence ethical sensitivity to a greater degree than do personality traits.

For example, Darley and Latane (1968) found that the number of other bystanders present significantly affected the likelihood of helping in an emergency, but personality and background measures had no similar influence. Also, Darley and Batson (1973) found that subjects placed under time pressure were more likely to pass by a person in apparent need of help than subjects operating at a more leisurely pace. Various religious personality variables were not predictive of helping behavior among Darley and Batson's (1973) subjects.¹

The importance of context on ethical sensitivity is also supported by the results of a study by Volker (1984), who found no differences in the moral sensitivity of novice and experienced counselors. As observed by Shaub et al. (1993), this finding suggests that the context of clinical diagnosis encourages experienced counselors to become preoccupied with technical issues to the detriment of their ethical sensitivity.

The current study investigates whether a similar phenomenon occurs among professional auditors. The primary issue of concern is the effect of a contextual variable, the public accounting environment, on sensitivity to common ethical problems faced by auditing practitioners. During their formal university education, aspiring auditors should be sensitized to common ethical issues faced by practitioners due to the emphasis on ethics in undergraduate auditing courses. However, ethical sensitivity should be lower in an environment in which ethical issues and ethical standards are not emphasized and reinforced. It is well known that the competitive nature of the public accounting environment requires a constant focus on efficiency in conducting audits. In such an environment, it appears likely that young auditors will also become preoccupied with the technical aspects of the engagement, and may not attend to "softer" issues such as potential ethical problems. This reasoning leads to the following hypothesis:

H₁: Experienced auditors will be less sensitive to ethical issues than auditing students.

Little evidence relevant to this hypothesis has been reported in the auditing literature. Shaub et al. (1993) tested professional auditors' sensitivity to three ethical issues embedded in an auditing case. Overall, their subjects appeared to be relatively insensitive to ethical issues, with the average subject identifying less than half of the presented issues. However, the Shaub et al. study did not address the effects of experience on ethical sensitivity.

Wright et al. (1996) tested the effectiveness of an educational intervention on auditing students' ability to recognize ethical issues. These authors suggested that issue recognition is a joint function of an individual's ethical sensitivity and the moral intensity of the issues (Jones 1991), although this hypothesis was not explicitly tested. The Wright et al. (1996) student subjects appeared to be more sensitive to ethical issues than the Shaub et al. (1993) subjects, with the average student identifying approximately 66 percent of the issues included in the pretest. In contrast, the Shaub et al. (1993) subjects identified about 75 percent of the issues included in the posttest. While these findings are consistent with H₁, it is difficult to compare the two studies because they used different experimental cases.

Sensitivity to Technical Issues

In the preceding section, it was suggested that the public accounting environment encourages auditors to focus on technical performance and efficiency rather than ethical issues. The ability to identify technical issues is obviously important to the successful conduct of an audit engagement. For example, the presence of contentious or difficult accounting issues increases audit risk at the financial statement level (AICPA, 1995). If the auditor fails to recognize such issues, significant errors or omissions in the financial statements may go undetected. To illustrate, assume that during the planning phase of an engagement the auditor learns that the client guaranteed the debt of a related company. If the auditor fails to recognize that this transaction creates a potential contingent liability, important information may be omitted from the financial statements.

Due to the importance of technical competence in auditing, it is reasonable to assume that public accounting firms will encourage and reward this type of skill. Much anecdotal evidence supports this contention; for example, the performance evaluation forms used by most CPA firms include criteria relating to technical competence and knowledge of accounting and auditing standards. If firms emphasize and reward technical proficiency we would expect experienced auditors to focus primarily on technical issues. This reasoning leads to the following hypothesis:

H₂: Experienced auditors will be more sensitive to technical issues than auditing students.

Limited evidence supporting this hypothesis has appeared in the auditing literature. For example, Bonner and Lewis (1990) found that audit managers possessed more knowledge of

the nature of and proper accounting for hedging transactions than did audit seniors or auditing students, and that this knowledge was significantly related to performance on a related auditing task. Shafer et al. (1995) required subjects to read descriptions of complex financial accounting transactions as part of an audit planning task. Subjects then completed a surprise free recall task and also provided explanations of the perceived significance of accounting issues. The study found that experienced subjects recalled more of the important case information and made a greater number of meaningful inferences relating to financial accounting issues than did auditing students. These results indicate that the experienced subjects possessed more knowledge of generally accepted accounting principles, and were better able to apply this knowledge to facilitate the comprehension of nonroutine transactions and events.

RESEARCH METHODOLOGY

An experimental study of practicing auditors and auditing students was conducted in order to test hypotheses H_1 and H_2 . This section will discuss the research subjects, experimental materials and administration, and scoring of issues.

Subjects

Three groups of subjects participated in this study: auditing students, experienced staff auditors, and experienced senior auditors. Demographic information for each subject group is provided in Table 1. The student subjects were all senior accounting majors attending a medium-sized state university. The students completed the experiment during the last scheduled class meeting for their introductory auditing course. During the second week of the quarter, the students were exposed to the typical coverage of the AICPA Code of Professional Conduct included in undergraduate auditing texts. This information was tested on the mid-term examination, but not on the final examination. Thus, the students had not studied the Code of Professional Conduct for several weeks prior to the completion of the experiment.

It should also be noted that the student subjects in this study were actually an average of two years older than the experienced subjects. Because ethics researchers such as Kohlberg (1969) have proposed that moral development increases with age, this was a potentially confounding variable. However, as reported in the results section, we found no significant relationship between age and ethical sensitivity in our sample.

The experienced subjects were all employed by a single international accounting firm. Experienced subjects completed the experiment during scheduled in-house technical training sessions.

Table 1
Summary of Demographic Information

	<u>Auditing Students</u>	<u>Staff Auditors</u>	<u>Senior Auditors</u>	<u>All Subjects</u>
Number	65	54	44	163
Means:				
Age	28	26	26	27
Auditing Experience (mos.)	0	18	34	15
Proportion of:				
Males	52%	54%	55%	53%
Females	48%	46%	45%	47%
CPA's	0%	6%	34%	11%

Experimental Materials and Administration

The basic methodology for this study was adapted from Shaub et al. (1993), and required subjects to read an experimental case and identify issues they perceived to be important. The case developed for the current study is presented in Appendix 1, and descriptions of ethical, technical, and administrative issues raised in the case are presented in Appendix 2. The case was developed by one of the authors, who has several years of professional auditing experience. The case materials were reviewed by three CPA firm partners with extensive auditing experience, who all agreed that the case seemed realistic and the issues identified by the authors were valid issues.

The descriptions of the four technical accounting issues included in the case were adapted from actual footnote disclosures included in the annual reports of publicly-held companies. A fifth technical issue, relating to the turnover of key client personnel, was added to the list of legitimate issues because it was identified by almost half of the experienced subjects in this study and is also supported by professional auditing standards.²

The ethical issues included in the case were adapted from a variety of sources, including professional codes of conduct and previous research studies. Since the primary focus of this research is on sensitivity to ethical issues that are practically significant, an effort was made to include some of the major ethical problems encountered by professional auditors. For example, three of the six issues dealt with a potential conflict of interest/independence problem, which was cited by more practitioners than any other auditing issue as the job situation that poses the most difficult ethical or moral problem for them personally (Finn et al. 1988).³ The case also included a client proposal for the use of questionable accounting principles, which was the second most frequently cited auditing ethical problem (Finn et al. 1988). Additional justification for the inclusion of individual issues is provided in Appendix 2.

The two administrative issues in Appendix 2 were included because they were identified by a relatively large number of experienced subjects and appear to be legitimate concerns. No other issues were identified by a significant number of subjects.

All subjects completed the experiment in a classroom setting. Subjects were given an overview of the task, including time restrictions, and allowed to read the instructions. Subjects were then given a total of 30 minutes to read the case, identify the significant issues, and rate the perceived significance of each identified issue. Upon completion of the issue identification task, subjects completed the Ethics Position Questionnaire⁴ and a demographic questionnaire.

Scoring of Issues

All issues were independently categorized by both authors. The percentage of agreement based on the initial categorizations was 90 percent. All differences in categorization were resolved through discussion and mutual agreement.

EXPERIMENTAL RESULTS

Ethical Issues

The percentage of subjects identifying each of the six ethical issues is presented in Table 2. As indicated in the table, the auditing students identified an average of 2.72 ethical issues, which was significantly greater than the number identified by staff auditors (2.05) or senior auditors (2.20) based on t-tests. These results support H_1 . The senior auditors identified slightly more ethical issues than the staff auditors, but the difference was not statistically significant. Similar results were obtained when the ethical issues were weighted by their significance ratings; thus, those results are not presented in detail.

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A higher percentage of the student subjects identified each of the ethical issues, with the exception of issue six. Chi-square tests indicated that the differences in percentages were statistically significant for three of the six issues.

A general linear model analysis for ethical issues is reported in Table 3.

In Panel A of the table, the dependent variable is the ethical summate, or the mean number of ethical issues identified by each subject. The univariate results indicate that the effect for experience is highly significant, which also supports H_1 . However, the percentage of total variation in ethical sensitivity explained by experience is quite low ($R^2=.06$).

A multivariate analysis was also performed to test for relationships between ethical sensitivity and several individual difference variables, including subjects' idealism and relativism as measured by the Ethics Position Questionnaire, as well as age, sex, and CPA status. In the multivariate model, the experience variable remains highly significant, but none of the other independent variables approach significance. Thus, unlike Shaub et al. (1993), this study finds no significant relationship between ethical ideology and sensitivity to auditing issues.

In Panel B of Table 3, the dependent variable is the ethical significance summate, which is computed for each subject by summing the significance ratings for each identified issue. The results of this analysis are very similar to those based on the ethical summate. Again, the experience variable is significant in both models, and none of the other independent variables are significant at the .05 level.

Technical Issues

The percentage of each subject group identifying each of the five technical issues is reported in Table 4. The results are in sharp contrast to those obtained for ethical issues, as hypothesized. The staff (senior) auditors identified an average of 2.90 (2.72) technical issues, compared with a student average of only 1.12. Thus, the average for the experienced auditors was more than double that of the auditing students, and the differences between the means of the two auditor groups and the student group were statistically significant. These results provide strong support for H_2 . Again, the difference between the means of the staff and senior auditors was not significant. Similar results were obtained when the technical issues were weighted by their significance ratings; thus, those results are not presented in detail.

The percentage differences for each of the individual technical issues were significant based on chi-square tests, as indicated in Table 4. The general linear model results for technical issues, presented in Table 5, also strongly support H_2 .

Table 2

Percentage of Subjects Identifying Ethical Issues

Issue:	<u>Auditing Students</u>	<u>Staff Auditors</u>	<u>Senior Auditors</u>	<u>All Subjects</u>
1. Eating Hours ^a	.43 (.49)	.33 (.47)	.34 (.48)	.37 (.48)
2. Reducing Audit Scope	.83 (.38)	.83 (.37)	.77 (.42)	.81 (.39)
3. Subordination of Judgement	.35** (.48)	.07 (.26)	.20 (.41)	.22 (.42)
4. Accounting Services	.25* (.43)	.09 (.29)	.07 (.25)	.14 (.35)
5. Recruiting	.26* (.44)	.05 (.23)	.07 (.25)	.14 (.35)
6. Job Offer	.60 (.49)	.67 (.48)	.75 (.44)	.66 (.47)
Ethical Summate ^b	2.72*** (1.40)	2.05 (.890)	2.20 (1.07)	2.36 (1.19)

^a Numbers without parentheses represent the percentage of subjects who identified the issue; numbers in parentheses represent standard deviations.

^b Mean number of ethical issues (0-6) identified.

* Differences in percentages are significant at the .01 level based on Chi-square tests.

** Differences in percentages are significant at the .001 level based on Chi-square tests.

*** Difference between student mean and staff and senior auditor means is significant at the .05 level based on t-tests. Staff and senior auditor means are not significantly different.

Table 3

General Linear Model Results For Ethical Sensitivity

Panel A: Dependent Variable = Ethical Summate^a

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			0.06
Experience ^b	5.4	0.0054	
Multivariate Model:			0.09
Experience	5.4	0.0053	
Idealism	0.05	0.8175	
Relativism	0.96	0.3277	
Age	0.39	0.532	
Sex	1.06	0.3049	
CPA	1.49	0.2234	

Panel B: Dependent Variable = Ethical Significance Summate^c

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			0.05
Experience	4.58	0.0116	
Multivariate Model:			0.09
Experience	4.37	0.0143	
Idealism	0.13	0.7155	
Relativism	0.65	0.4219	
Age	1.46	0.2294	
Sex	0.39	0.5328	
CPA	2.83	0.0947	

^a Mean number of ethical issues (0-6) identified.

^b Student, staff, or senior

^c Computed for each subject by summing the significance ratings for each ethical issue identified.

Table 4
Percentage of Subjects Identifying Technical Issues

Issue:	<u>Auditing Students</u>	<u>Staff Auditors</u>	<u>Senior Auditors</u>	<u>All Subjects</u>
1. Discontinued Operations ^a	.29** (.46)	.78 (.42)	.77 (.42)	.58 (.49)
2. Contingent Liability	.27* (.45)	.52 (.50)	.43 (.50)	.40 (.49)
3. Sale-Leaseback Accounting	.31** (.47)	.80 (.41)	.79 (.41)	.60 (.49)
4. Related Party Transaction	.09** (.29)	.37 (.48)	.27 (.45)	.23 (.42)
5. Turnover of Key Personnel	.15** (.36)	.44 (.50)	.45 (.50)	.33 (.47)
Technical Summate ^b	1.12*** (.99)	2.90 (1.08)	2.72 (1.19)	2.14 (1.38)

^a Numbers without parentheses represent the percentage of subjects who identified the issue; numbers in parentheses represent standard deviations.

^b Mean number of technical issues (0-5) identified.

* Differences in percentages are significant at the .05 level based on Chi-square tests.

** Differences in percentages are significant at the .001 level based on Chi-square tests.

*** Difference between student mean and staff and senior auditor means is significant at the .05 level based on t-tests. Staff and senior auditor means are not significantly different.

The univariate analysis in Panel A indicates that the experience variable is highly significant and explains almost 40 percent of the variation in the number of technical issues identified. As in the case of ethical issues, the individual difference variables tested in the multivariate model were not significant.⁵ The results in Panel B, which are based on subjects' perceived significance of the technical issues, are very similar to those in Panel A.

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Administrative Issues

As previously discussed, a large number of experienced subjects identified two issues that were considered administrative in nature. These issues were not identified by the authors prior to the administration of the experiment; however, they appear to legitimate concerns and were separately analyzed. Table 6 presents the percentages of each subject group identifying each of the two issues. As shown in the table, approximately 20 percent of the experienced subjects were concerned about meeting the current year audit budget, while approximately 35 percent were concerned about engagement scheduling. The average number of administrative issues identified by the experienced subjects was significantly greater than the student average. The general linear model results presented in Table 7 also indicate that experience is significantly related to the number of administrative issues identified, as well as the perceived significance of those issues. As in the case of ethical and technical issues, individual difference variables were not significant.

LIMITATIONS AND DISCUSSION

As an initial test of the effects of auditing experience on both ethical and technical sensitivity, this study was exploratory in nature, and is subject to a number of limitations. For example, the use of subjects from a single university and a single public accounting firm limits the generalizability of the results. Furthermore, the experienced subject group contained relatively few CPAs, and no managers or partners. Future studies should test the generalizability of our findings by examining different subject groups as well as more experienced subjects. It is particularly important to test the ethical and technical sensitivity of firm partners and managers, since higher level personnel have the ultimate responsibility for the firm's work, and because they usually create an ethical atmosphere that influences all firm personnel.

However, if the findings of this study are confirmed by future research, they do have important implications for public accounting practitioners. We found that, in an audit planning context, experienced senior and staff auditors tended to focus on technical issues, and failed to recognize potentially significant ethical problems. In contrast, auditing students identified significantly more ethical issues.

Two factors suggest that these findings were primarily the result of subjects' environment rather than knowledge or skill differences. First, if the results were based on knowledge or skill differences developed through auditing experience, the senior auditors should have outperformed the staff auditors, which was not the case. Second, the technical issues included in the experimental case were all based on the type and level of knowledge tested on the CPA examination, but experienced subjects who had passed the CPA exam performed no better on technical issues than those who had not.

Table 5

General Linear Model Results For Technical Sensitivity

Panel A: Dependent Variable = Technical Summate^a

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			.39
Experience ^b	49.04	.0001	
Multivariate Model:			.39
Experience	46.86	.0001	
Idealism	.13	.7162	
Relativism	.02	.8896	
Age	.13	.7153	
Sex	2.04	.1553	
CPA	.55	.4606	

Panel B: Dependent Variable = Technical Significance Summate^c

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			.33
Experience	39.96	.0001	
Multivariate Model:			.34
Experience	38.10	.0001	
Idealism	.00	.9709	
Relativism	.57	.4515	
Age	.01	.9094	
Sex	1.17	.2812	
CPA	.33	.5693	

^a Mean number of technical issues (0-5) identified.

^b Student, staff, or senior

^c Computed for each subject by summing the significance ratings for each technical issue identified.

Table 6
Percentage of Subjects Identifying Administrative Issues

Issue:	<u>Auditing Students</u>	<u>Staff Auditors</u>	<u>Senior Auditors</u>	<u>All Subjects</u>
1. Meeting the Budget ^a	.08* (.27)	.20 (.41)	.20 (.41)	.15 (.36)
2. Engagement Scheduling	.03** (.17)	.30 (.46)	.39 (.49)	.21 (.41)
Administrative Summate ^b	.11*** (.31)	.50 (.67)	.59 (.69)	.36 (.59)

^a Numbers without parentheses represent the percentage of subjects who identified the issue; numbers in parentheses represent standard deviations.

^b Mean number of administrative issues (0-2) identified.

* Differences in percentages are significant at the .10 level based on Chi-square tests.

** Differences in percentages are significant at the .05 level based on Chi-square tests.

*** Difference between student mean and staff and senior auditor means is significant at the .05 level based on t-tests. Staff and senior auditor means are not significantly different.

An alternative explanation for the superior performance of the professional auditors in identifying technical issues is that these subjects may be more intelligent because it is likely that they were outstanding students. It is well known that large CPA firms such as the one participating in this study tend to hire graduates with high grade point averages. However, if this is the case, this makes the superior performance of the auditing students in identifying ethical issues all the more significant. If the professional auditors possessed superior intelligence, this should have enabled them to identify more of the ethical issues included in the case as well as the technical issues, and would have biased the study against our first hypothesis.

The findings of this study raise concerns about the ethical sensitivity of young professionals. Of the six ethical issues included in the experimental case, only two were identified by more than half of the subjects. Issue two, relating to the reduction of audit hours in order to maintain the profitability of the engagement, was identified by a strong majority of all subject groups. Issue six, receiving a job offer from a client, was also identified by the majority of all subjects, and is the only ethical issue identified by a higher percentage of auditors than students. The experienced subjects were relatively insensitive to the remaining issues.

Table 7

General Linear Model Results For Administrative Sensitivity

Panel A: Dependent Variable = Administrative Summate^a

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			.12
Experience	11.24	.0001	
Multivariate Model:			.14
Experience	10.82	.0001	
Idealism	.75	.3871	
Relativism	.14	.7049	
Age	1.50	.2230	
Sex	.60	.4416	
CPA	.71	.4005	

Panel B: Dependent Variable = Administrative Significance Summate^c

<u>Independent Variables:</u>	<u>F-Value</u>	<u>p > F</u>	<u>Model R²</u>
Univariate Model:			.10
Experience	8.72	.0003	
Multivariate Model:			.12
Experience	8.26	.0004	
Idealism	.22	.6433	
Relativism	.36	.5472	
Age	1.51	.2211	
Sex	.31	.5810	
CPA	1.22	.2708	

^a Mean number of administrative issues (0-2) identified.

^b Student, staff, or senior

^c Computed for each subject by summing the significance ratings for each administrative issue identified.

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It is interesting to note that issue one, eating hours, was identified by only about one-third of the experienced subjects. In contrast, this issue was identified by over 80 percent of the experienced subjects in the Shaub et al. (1993) study, even though the wording of the issue in the two experimental cases was virtually identical. The difference could be attributable to the fact that the case used in the current study included substantive technical issues which had a distracting effect. This is consistent with Shaub et al.'s (1993) observation that professionals' preoccupation with technical issues may reduce their ethical sensitivity. Another possibility is that the time restriction imposed in the current study had a negative impact on ethical sensitivity. No similar restriction was imposed on the Shaub et al. (1993) subjects.

Issue three was based on the auditor's acquiescence with the client's desired accounting treatment if "any support" for the client's position existed. Only seven percent of the staff auditors and twenty percent of the senior auditors identified this issue. The need for auditors to be sensitive to this type of situation is widely recognized. For example, the Macdonald Commission of Canada noted that

...the auditor has a particular responsibility, when faced with situations for which there is no clear precedent, to be satisfied that the accounting proposed is reasonable in relation to the substance or economic reality of the thing or transaction accounted for (1988, cited in Public Oversight Board, 1993, p. 47).

It is interesting to note that auditing practitioners have recently come under criticism for failing to meet this responsibility. For example, the Public Oversight Board of the AICPA made the following observation:

The Board's review of cases of alleged audit failure studied by the QCIC in recent years indicates that in many such cases consultation on accounting matters had occurred and the matters had been extensively considered and debated. In too many cases, however, the preference of client management-influenced at least in part by objectives other than producing the most reliable financial reporting possible in the circumstances-nevertheless prevailed over the preference of the auditing or consulting partner (POB, 1993, p. 48).

In response to such criticisms, an advisory panel of the Public Oversight Board recently suggested that auditors should forthrightly communicate to corporate boards and audit committees their views on the *quality*-not just the *acceptability*-of a company's financial reporting (Kirk and Siegel, 1996).

The wording of this issue in the experimental case was designed to test if subjects would recognize the ethical problem created by the hypothetical auditor's willingness to be unduly influenced by the preferences of client management. The experienced subjects' insensitivity to

this issue is not inconsistent with criticisms currently being leveled against the auditing profession.

Finally, although issues four and five have been the subject of ethics interpretations and rulings by the AICPA, they were acknowledged by less than ten percent of both experienced subject groups. Again, this suggests inadequate ethical sensitivity on the part of the young professionals participating in this study.

CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

The results of this study suggest that working in the professional auditing environment improves the ability to recognize technical auditing and accounting issues, but does not enhance sensitivity to ethical issues. If supported by future research, these findings appear to have important implications for public accounting firms. In particular, they suggest that auditing practitioners need to place more emphasis on the development of young professionals' ethical sensitivity. Since senior and staff auditors do the majority of the work on most engagements, they are in a position to observe many potential ethical issues that may not come to the engagement manager or partner's attention. Therefore, the failure of these lower-level personnel to recognize potential ethical problems may ultimately compromise the professionalism of the firm.

There has been a great deal of debate regarding the effectiveness of ethics education. However, Wright et al. (1996) recently found that educational interventions based on stakeholder theory improved accounting students' ability to recognize ethical issues. Perhaps public accounting firms should integrate similar educational interventions into their regular training schedules. Future research should investigate the effectiveness of such interventions when included as part of the continuing education programs of accounting firms.

There is also a need for additional research on the determinants of ethical and technical sensitivity. The experience variable in our study explained less than ten percent of the variation in ethical sensitivity, and none of the individual difference variables examined were significant. However, like studies in the social psychology literature, this study implies that contextual or situational variables may play a key role in ethical sensitivity. For example, the fact that the experienced subjects in this study were much less likely to identify the issue of eating hours than the Shaub et al. (1993) subjects suggests that the inclusion of technical issues or the time limitation imposed may have distracted subjects from ethical considerations. Future research should explore the effects of such situational variables on auditors' ethical sensitivity. Future research should also address the determinants of technical sensitivity, or the ability to identify technical auditing and accounting issues. Although this skill is obviously important to the effective and efficient conduct of an audit engagement, it has received very little attention. This

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study found that experienced auditors outperformed students at issue identification, but did not outperform staff auditors. As indicated in the discussion, this suggests that the auditor/student differences in technical sensitivity may be attributable to a selection bias (i.e., CPA firms screen out less competent graduates) rather than experience effects. However, this raises an obvious question as to why experience does not enhance the ability to recognize technical issues. Research similar to that conducted by Bonner et al. (1992) in a tax planning context could help clarify the determinants of technical sensitivity in auditing.

NOTES

1. Other studies in the social psychology literature also raise doubts about the significance of personality variables as predictors of ethical sensitivity. For example, Pinto and Kanekar (1990) hypothesized that subjects scoring high on machiavellianism would be relatively insensitive to ethical characteristics in their evaluation of a hypothetical stimulus person. However, they found no consistent support for this hypothesis.
2. None of the results or conclusions of this study differ when this issue is omitted from the analysis.
3. The ethical problem most frequently cited by practitioners was client proposals for tax alteration and tax fraud, which is not within the scope of this study.
4. The Ethics Position Questionnaire is a standard psychological instrument designed to measure a person's ethical ideology. Because Shaub et al. (1993) found a significant relationship between ethical ideology and ethical sensitivity, the instrument was administered in the current study for purposes of replication.
5. There was no a priori reason to suspect any association between technical sensitivity and ethical ideology (idealism and relativism), but these variables were tested for the sake of completeness. The results of the analysis are similar when these variables are excluded from the model.

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Appendix 1

Experimental Case

Instructions

You are about to read a brief auditing case. To the extent possible, place yourself in the CPA's shoes. Different aspects of the case would vary in significance to you were you to encounter them in reality. I am interested in finding out what would be important to you.

Auditing Scenario

John Simmons is an audit manager with a national CPA firm. He was recently assigned the audit of Consolidated Stores, Inc. (CSI), a continuing audit client, for the fiscal year ending January 31, 1996. CSI, which is one of the firm's largest auditing and consulting services clients, owns and operates several national retail department store chains. Through its wholly-owned subsidiary, Holmes Co., CSI is also a wholesale distributor of premium-priced ladies clothing. CSI has been a profitable client in the past; however, the current-year audit budget was reduced significantly from prior-year levels in order to retain the engagement. John also learned from Jane Robinson, the senior on the prior-year audit, that the prior-year actual hours were understated due to the failure of some staff people to charge their wheel-spinning time to the engagement. As a result, John feels that it will be necessary to reduce the extent of auditing procedures from previous years in order to ensure that the engagement is profitable.

As part of the preliminary planning process, John met with Jim Ellis, the controller of CSI, during September 1995 to discuss general matters relating to the engagement. John planned to schedule some interim fieldwork for the first two weeks in December, and wanted to make sure the client would be prepared. After discussing preliminary matters and going over CSI's interim financial results, Ellis indicated that he was concerned about the effects of several factors on the current-year audit and financial statements.

His first concern was that CSI was considering a spin-off of Holmes Co. If approved, the spin-off would be completed during December, 1995 by distributing Holmes stock to the CSI stockholders of record at the close of business on November 15, 1995. After the spin-off, CSI would own no shares of Holmes stock, but would guarantee Holmes' debt obligations up to \$50 million until Holmes' achieved certain financial ratios. Ellis said he was not sure how the spinoff would affect the current-year financial statements.

Ellis also indicated that during August, 1995, a corporation that was partially owned by CSI purchased 37 of the company's department store properties for approximately \$400 million and leased the stores back to the company for a 10-year base term, plus renewal options. At the end

of the initial lease term CSI has an option to repurchase the stores for a cash price of approximately \$200 million. According to Ellis, the company will probably repurchase the properties, since the fair market value of the stores at the end of lease term is expected to be significantly more than \$200 million. Ellis said that the management of CSI wants the transaction to be accounted for as a sale/leaseback. Although John's initial reaction was that the deal was simply a financing arrangement, he agreed to research the reporting requirements and assured Ellis that he would agree with sale/leaseback treatment if there was any support for this position.

Finally, Ellis expressed concern about whether CSI would be ready to start the fieldwork during December, since Bob Jackson, one of the company's accounting managers, had recently resigned and a qualified replacement had not been found. John suggested that if a replacement was not found soon, his firm might be able to provide assistance in helping CSI prepare for the audit, and that he might be able to assist in the recruiting process or recommend someone for the job. He was somewhat surprised when Ellis asked if he was interested in the position himself. He thanked Ellis and told him he would consider his offer. On the way back to the office, John thought about how hard he had been working during the past few months, and remembered that his wife had recently suggested that he consider leaving public accounting.

PLEASE INDICATE BRIEFLY THE NATURE AND SIGNIFICANCE OF ANY ISSUES YOU WOULD BE CONCERNED WITH IN THIS SCENARIO. SIMPLY INDICATE:

1. THE SIGNIFICANCE OF THE ISSUE BY CIRCLING A NUMBER BETWEEN ONE AND SEVEN; AND
2. THE NATURE OF THE ISSUE ON THE LINES BELOW THE CIRCLED NUMBER. YOU DO NOT NEED TO INDICATE HOW YOU WOULD RESOLVE ANY ISSUES.

Very Insignificant Issue

Very Significant Issue

1 2 3 4 5 6 7

Issue: _____

Appendix 2

Issues Included in Auditing Case

Ethical Issues:

1. The fact that prior year actual hours were understated due to the failure of some staff members to fully charge their time raises the general ethical issue of "eating time". Although this issue is not specifically addressed in the AICPA Code of Professional Conduct, it was one of the three issues included in the Shaub et al. (1993) study, and was included here for purposes of replication.
2. John's intention to reduce the extent of auditing procedures to maintain the profitability of the engagement indicates a potential impairment of several general auditing standards, such as the requirement to exercise due care in the performance of the engagement and the requirement to obtain sufficient, competent evidential matter. Due to intense competition, this has been a major issue facing the profession for several years, and has been extensively discussed in both the practitioner and academic literature.
3. John's assurance that he would agree with sale/leaseback treatment if there was any support for this position indicates a potential subordination of judgment problem. This has been another major issue facing the profession over the past several years, and was recently addressed by the Public Oversight Board of the AICPA.
4. If John's firm provides assistance in helping CSI prepare for the audit, this may impair independence. The auditor's responsibility under AICPA rules in this case is set forth in Interpretation 101-3 of the Code of Professional Conduct, which stipulates that independence is impaired when a member provides accounting or bookkeeping services to a client, unless certain conditions are met. For example, the member must not assume the role of employee or of management. The situation described in the case involves the CPA offering assistance due to an accounting manager's resignation; thus, there is a clear implication this assistance would involve more than routine bookkeeping functions. This issue was included to test if the frequency with which CPA firms provide various types of client assistance has desensitized practitioners to their professional responsibility to carefully evaluate the nature of such services and their potential impact on independence.
5. Jacobson's participation in the recruitment of a new controller for JPW is a potential impairment of independence. The AICPA has ruled that, assisting a client in recruiting and hiring employees impairs the auditor's independence. However, an auditor may perform services such as developing a position description and candidate specifications and recommending qualified candidates for a position, provided client management is

responsible for any ultimate hiring decision. Several previous studies of auditor independence judgments have addressed this situation.

6. The fact that Ellis asked John if he was interested in the accounting position is also a potential impairment of independence. The AICPA ethical rules stipulate that, if an employee of an auditing firm receives an offer of employment from an auditing client during the course of an engagement, that employee's independence is impaired as long as the offer is outstanding.

Technical Issues:

1. Spin-off/Discontinued operations. The spin-off of Holmes Co. should be accounted for as a discontinued operation, since JPW has no continuing interests which operate the same line of business or sell to the same class of customer.
2. Contingent liability/Off-balance-sheet Risk. Assuming that a loss is at least reasonably possible, JPW's guarantee of the debt of Holmes is a contingent liability which should be disclosed in the 1995 financial statements. The amount of off-balance-sheet risk created by financial guarantees written is also required to be disclosed pursuant to SFAS 105.
3. Applicability of sale-leaseback accounting. The sale and leaseback of the 37 stores raises a question regarding the applicability of sale/leaseback accounting. Since JPW intends to repurchase the properties at the end of the lease term, this appears to be simply a financing arrangement.
4. Related party transaction. The purchase and leaseback of the department stores by a company that is partially owned by CSI is a related party transaction.
5. The turnover of key accounting personnel and resulting difficulty in being prepared for the audit on time should alert the auditor to the possibility of errors and irregularities.

Administrative Issues:

1. Reduced budget. The reduction in the current year audit budget will result in difficulty in completing the audit within the budgeted number of hours. Credit for this issue was given if subjects discussed the problem of meeting the budget without making any reference to the reduction in auditing procedures to maintain the profitability of the engagement (the second ethical issue). Most of the subjects who identified this issue separately identified the related ethical issue.

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2. The client's difficulty in preparing for the audit indicates that the start of the audit may have to be delayed. This may create scheduling problems for the firm.

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