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Auditor independence and client economic power: Qualitative evidence and propositions involving auditors' emotions and moral reasoning

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ABSTRACT

This study views auditor independence decision-making as holistic, complex and interpersonal, where human elements including emotions come into play when challenged by a morally intense situation. The idea of emotions affecting auditor independence judgments has had little attention in auditing research. In fact, rationality and emotions cannot be separated because they are part of the human condition, often complimenting each other in decision making. To reflect this view, our interactionist model of auditors' complex decision making includes Rest's four-component model, (1) moral sensitivity, (2) moral reasoning, and (3) moral motivation as decision-making processes culminating in moral behavior that denotes (4) moral character. We propose that client management economic pressure is a situation of high moral intensity that sensitizes auditors' emotions and thus motivates their moral reasoning to make deliberative decisions either to resist (a moral judgment) or accede to client management wishes, showing principled, accommodating or pragmatic character.

Key words: auditor independence, moral reasoning, emotions

Auditor Independence and Client Economic Power: Qualitative Evidence and Propositions involving Auditors' Emotions and Moral Reasoning

1. Introduction

Accountant auditors are mandated by law and professional standards to provide an independent opinion about the veracity of corporate reporting in the public interest and for the economic well-being of society. Without strong auditor independence the integrity of corporate financial disclosures is threatened by possible audit failures that detrimentally affect the public. Yet a court-appointed United States (US) bankruptcy examiner revealed the collapse of Lehman Brothers as major audit failure. The examiner stated that grounds existed for legal claims against Lehman Brothers' senior management and the auditor Ernst & Young for signing off misleading accounting statements just prior to the collapse of the Wall Street Bank which precipitated the worst financial crisis since the Great Depression.

“A judge last night unsealed a 2,200-page forensic report by expert Anton Valukas into Lehman's collapse which includes scathing criticism of accounting “gimmicks” used by the failing bank to buy itself time. These included a contentious technique known as “repo 105” which temporarily boosted the bank's balance sheet by as much as \$50bn... . (Clarke 2010).

In fact,

“Leading accountancy firm Ernst & Young is facing legal action for its alleged role in ‘window dressing’ the accounts of Lehman Brothers as it careered toward collapse. New York attorney general Andrew Cuomo is reportedly preparing to sue the firm as early as this week. The case would be the first against a major accounting firm over its role in the credit crisis.” (Rushe 20 December 2010).

Why did the Ernst & Young auditor allow the perpetration of such a significant accounting fraud to boost Lehman's profit (see Valukas 2010) when the profession has ethical obligations to be independent of the client? Professional codes of ethics require accountant

auditors “to be fair, intellectually honest, and free of conflicts of interest”¹ (International Federation of Accountants IFAC 2005). Further, the profession’s credibility and legitimacy (Hines, 1991) are sustained by the public’s perception of auditors having the moral character to provide independent verification of corporate financial reports. The profession and the accounting firms appear to view audit failures such as Lehman Brothers as the result of a ‘few bad apples’ that do not taint the rest of the ‘barrel’. A ‘few bad apples’ however, who lack moral character but gain positions of authority with power over organizational promotion and reward systems, can spread the rot thus tainting the barrel and harming the wider community (Ashkanasy et al. 2006).

For example, Arthur Andersen’s CEO Joe Berardino attracted the fulcrum of blame for AA’s demise associated with Enron’s collapse although bankers, politicians, regulators and other Big 5 accounting firms are implicated (see Morrison 2004 in defense of AA). AA’s founder Professor Andersen stood for integrity, however the deregulated audit market instituted in the 1970s helped create lucrative but dominant corporate consulting services, weakening the core value of independence in favor of business (Zeff 2003a, 2003b; Wyatt 2004). When Andersen Consulting (now Accenture) split from the parent firm taking \$9.5 billion, CEO Berardino was compelled to chase revenue sacrificing audit quality and ignore the systemic flaw of Andersen’s Huston practice director overruling their Professional Standards Group (PSG) objections about several questionable Enron transactions. Andersen was the only Big 5 firm to allow a local office to overrule their PSG (Byrne 2002), hence the actions of a few but powerful ‘bad apples’ not only contaminated the AA barrel but also the public’s perception of AA. To maintain public trust in the financial industry politicians hastily promulgated the Sarbanes Oxley (2002) Act. Cullinan (2004, 862) maintains,

¹ A search of IFAC (2005) found 353 instances that guide auditors’ behavior in relation to the ‘client’ when performing statutory audits of corporate financial reports.

“... the US Congress chose to attack the symptoms of the audit breakdown exhibited in the Enron case, while not engaging in a more serious effort to identify and treat the underlying disease of a lack of a sense of public duty, and inadequate emphasis on audit competence in the audit profession’s culture.”

The recent audit failures and associated scandals suggest that not all auditors have the integrity and sense of public duty to competently perform their professional obligation to provide an independent opinion as a public duty.

Evidence indicates that auditors’ moral decision-making differs (Ponemon and Gabhart 1990, 1994) depending on the client context interaction with auditors’ personal attributes (Windsor and Ashkanasy 1995; Windsor and Warming Rasmussen 2009). Further auditors’ moral character differs with some principled auditors maintaining their independence in the face of client management pressure; other auditors accommodate client management demands to maintain the status quo (client business), and others pragmatically give in to client management only when it suits their self interest - or what’s in it for them.

The purpose of this study therefore is to examine auditor independence as a complex decision-making process that recognizes that auditors are social human beings, subject to a range of emotions, beliefs, prejudices and morals within the context of powerful social and cultural forces (Etzioni 1988a, b; Wartenberg 1990). The professional code of conduct (IFAC, 2005) implies that membership of a respected profession will imbue the altruism, virtues and strength of moral character to withstand the pressures of dealing with powerful corporate clients. Our interactionist model of auditor complex decision-making proposes that auditors respond differently to corporate client pressure because some auditors have the moral character, the principled ‘exemplars’ (Bailey et al. 2010) to remain independent of the client. In contrast some auditors are immoral driven by economic self-interest or ‘Homo

economicus' having psychopathic tendencies (Haidt 2001) that affect their decision-making. Further we argue that emotions sensitize moral reasoning when auditors are faced with an intense moral situation involving threats from client management (see Figure 1).

Figure 1 about here

Accordingly, this paper views auditor decision-making as holistic, complex and interpersonal, where human elements including emotions come into play when challenged by a morally intense situation. The idea of emotions affecting auditor independence judgments has had little attention in the auditing literature (see Chung et al. 2008; Gaudine and Thorne 2001). In fact, rationality and emotions cannot be separated because they are part of the human condition, often complementing each other in decision making (also see Haidt 2001, 2007; 2010; Monin et al. 2007; Narvaez 2010). To reflect this view, our model² of auditors' complex decision making includes Rest's (1986; Rest et al. 1994) four-component model, (1) moral sensitivity, (2) moral reasoning, and (3) moral motivation as decision-making processes culminating in moral behavior that denotes (4) moral character. Client management pressure is a situation of high moral intensity (Jones 1991) that sensitizes auditors' emotions and motivates their moral reasoning to make deliberative decisions either to resist (a moral judgment) or accede to client management wishes, thus showing principled, accommodating or pragmatic character.

Jones's (1991) issue-contingent theory provides the context and characteristics of the ethical issue, proposing that higher levels of moral intensity will activate higher levels of moral reasoning. We agree with Jones's (1991) proposition but include in our model auditors' moral judgment indicates their moral character (Rest 1986; Rest et al. 1994). For example, the

² Our model in this study is based on an earlier version developed by Windsor and Ashkanasy (1995) and replicated by Windsor and Warming Rasmussen (2009).

‘exemplar’ or principled auditors (Bailey et al. 2010) have the moral character to resist management pressure to provide a suspect opinion. The model also recognizes that auditors are human and therefore some auditors are principled while others are less so, lacking the moral character necessary to resist client management demands even though professional codes entreat auditors to be objective, fair, honest and independent.

The sections that comprise this paper follow the decisional processes of our model outlined in Figure 1. The next section analyses the situational context, the power imbalance inherent in the auditor-client management relationship using Wartenberg’s (1990) sociological “field theory of power”. Section 3 reports a qualitative study about auditors’ emotions elicited in this morally charged relationship, exacerbated by a flawed regulatory structure that makes auditors economically reliant on auditee companies, hence compromising independence. Section 4 brings together auditors’ emotions, moral reasoning and situational moral intensity to develop propositions that recognize auditors’ moral character variability recognizing that auditor’s do not all respond in the same way. In this study we propose that context creates moral intensity that sensitizes auditors’ emotions elicited in a challenging audit conflict with management. Those emotions motivate their levels of moral reasoning that result in the decision to accede or resist management pressure, signifying auditors’ moral character, as principled, accommodating or pragmatic. Section 5 discusses and concludes the propositions.

2. Client Management Power and Auditors’ Moral Sensitivity

The auditor-client management relationship inherently challenges auditors’ ethicality, since auditors are supposed to serve society rather than the economic interests of employer audit firms or their corporate clients (Mautz and Sharaf 1961; IFAC 2005). However, audit firms operate in a commercial environment and must rely on client fees for their economic survival.

The deregulated profession's focus on business (Mautz 1984; 1988) has placed auditors in an intense moral situation with their corporate clients (Jones 1991). When making professional judgments in the public interest auditors require moral sensitivity, as the first process, to make moral judgments and take subsequent action that denotes moral character (Rest et al. 1994). If auditors do not have moral sensitivity then significant audit conflicts are reduced to a business decision without recognition of the wider societal impacts.

As one audit partner interviewed in the course of this research frankly admitted,

“Public duty is important but audit is a business, not a science, and we have to make hard-nosed decisions If ethics is mixed with business, profits and efficiency suffer. It is difficult to combine the two.”

Hence auditors need to have the moral sensitivity (Rest 1986; Rest et al. 1994) to recognize that the client management relationship has a moral dimension beyond resolving an audit conflict for business reasons. Moreover, moral sensitivity is critical to ethical problem formulation and resolution to affect reflection, judgment and ultimately behavior that has wider societal implications (Jordan 2009). According to Goldman and Barlev (1974), auditors lack a crucial source of power and are vulnerable to economic pressure applied by client corporate management. The power differences among economic actors are inherent in an ethically challenging regulatory structure where auditors rely on the client for economic survival. These power differences deeply affect the actors' relationships because power differentials are gained by applying economic pressure. Goldman and Barlev (1974) define power relationships in terms of client management controlling the conditions of employment. Management not only knows the client company's true financial position but also provides the facilities and information necessary for auditors to prepare their report. Shareholders and third parties are not privy to company's internal financial information hence rely on the independent auditor's report to evaluate the company's financial position and management

performance. While Goldman and Barlev (1974) give examples of management's power over auditors, they do not provide a definition of "power".

This paper has adopted Wartenberg's (1990) sociological conception of power to examine the power dynamic of the auditor-client management relationship to influence auditors' decision making. Wartenberg's (1990) "field theory of power" defines power in terms of ongoing human relationships and interactions within a dynamic social context. His theory recognizes that power can be exercised in all spheres of human social life, going beyond the narrow perspective of political theorists. Wartenberg (1990) defines the difference between the positive "power to" (for example, power to the people) and the negative "power over". "Power over" refers to the individual or group (dominator) who exercises power over another individual or group (subordinate) by constraining the circumstances within which the weaker party acts. Thus, Wartenberg (1990) argues the mere presence of the dominator, the powerful group or individual, alters the social space or "field" of another individual or group, the subordinate.

The dominator acts to constrain the circumstances or situation of the subordinate by force, coercion, or influence, therefore limiting the subordinate's behavior. In the case of force, the dominator must expend energy and effort to block the subordinate's actions. Coercive power, on the other hand is more productive as the dominator is in the position to make an effective threat, but receives the benefits without having to do anything or expend resources. The least effective exercise of power is the dominator's use of influence to persuade the subordinate, however influence is not as effective as coercion. The critical difference between these three power positions is that the coercing individual or group presents a situation of limited options for the subordinate to act upon, hence coercion is the most effective form of power 'over'.

Situational power is a form of social power that concerns the control of resources (Greenhalgh et al. 1985). Furthermore, Greenhalgh et al. (1985) claim that when power is viewed as the reverse for dependence, one negotiator has favorable situational power when the other has a greater need to settle. The condition prevails when the reward structure is biased in favor of one negotiator and when one negotiator can deny the other their outcomes. Hence, in an audit dispute, client management has favorable situational bargaining power when they control the conditions of the auditor's employment through a regulatory structure that gives company management economic power over their auditors (Goldman and Barlev 1974; Knapp 1985).

This situational power gives management the edge and represents management's "power over" the auditor in their ongoing relationship. Although the auditee company has the legal power to appoint auditors, management generally negotiates the conditions of the auditors' employment (Goldman and Barlev 1974). As McCracken et al. (2008, 382) found "auditors appeared to be giving the CFOs the upper hand in positioning during the 'shadow' negotiation by not applying 'moves' themselves". Furthermore, management is privy to the auditee firm's information required by auditors to enable appropriate disclosure to the public. Management's power differential is further enhanced by being the nexus of all implicit and explicit contracts that constitute the firm (Hill and Jones 1992).

Wartenberg (1990) argues that power differentials become obvious when the dominant party, in this instance client management, applies economic pressure giving only limited options for subordinate or auditor behavior and decisions. Hence, client management's bargaining power over the auditor is enforced through applying economic pressure, for example, threatening to

switch auditors or reduce audit and non-audit services. Typically urgency or pressure generates low-quality beliefs and decisions by causing the subordinate (in this situation the auditor), to ignore long-term consequences of present choice, because the calculation of long-term and indirect effects is itself a time-consuming process (Elster 1999, 2009).

Auditors' fear of losing a client further exacerbates the power relationship between auditors and client corporate management in favor of management. Farmer et al. (1987) found that economic pressures, such as fear of losing a client, affected auditors' perceptions of independence attributes. For example, an auditor's fear of losing the client and associated economic rewards, may lead the auditor to inappropriately acquiesce to client management's demands or wishes. De Rivera (1989, 407) describes the negative impact of the emotion fear,

“One will be hurt and fear will become dominant. In such circumstances people will think that their dominant fear is realistic and they will begin to hold on to power or comply, inappropriately, with the wishes of others.”

This is clearly applicable in the economic context of the auditor-client management relationship, where the pressures to violate professional rules of conduct are inherent within the relationship (Goldman and Barlev 1974) that lacks public scrutiny or transparency.

Wartenberg (1990) contends that a power differential can benefit the subordinate parties in one respect but harm them in another. For example, a subordinate might be well paid, but lacking a sense of independence and self determination. In this instance, auditors are highly paid professionals, but their independence, integrity, and self determination depend upon the circumstances of their relationship with client management. Walster and Walster (1975) contend that the dominant group's philosophy will eventually be accepted as the status quo. In fact, both victims and exploiters frequently convince themselves that even the most uneven exchanges are fair (Walster et al. 1978). Hence, auditors need the moral sensitivity to see that

accepting management economic power over independence is to their collective detriment in the long run. The demise of large accounting firm Arthur Andersen in 2001 is evidence that some auditors unquestioningly accepted the status quo of client management economic power, accepted the lucrative fees, but sacrificed auditor independence and integrity to the detriment of the Arthur Andersen and the auditing profession (Cooper and Neu 2007).

In line with Wartenberg's (1990) theory of social power, the following qualitative field study was conducted to explore auditors' feelings about their relationship with client management. An action research approach was used to discover more about the auditor-client management relationship and the circumstances and situations controlled by management that impinge auditor independence. This study explores the auditor-client management relationship within the context of corporate client economic power based on Goldman and Barlev's (1974) model of audit-client balance of power, supported by Wartenberg's (1990) theory of social power.

3. Auditors' Emotions and Client-Management - A Qualitative Study

A series of unstructured interviews with auditors from the largest international audit firms set out to explore auditors' feelings in response to client management pressure and threats to independence. Prior studies have examined perceptions of auditor acquiescence to client management economic power experimentally (for example Knapp 1985; Windsor and Ashkanasy 1995; Windsor and Warming Rasmussen 2009). The purpose of this qualitative study is to investigate auditors' feelings regarding the auditor-client management relationship. Specifically, this study explores client economic bargaining power controlled by management that inhibited auditor independence, hence giving client management "power over" the auditor (Goldman and Barlev 1974; Wartenberg 1990). To gather the data,

interviews were organized with audit partners and a senior audit manager from the international audit firms in two large metropolitan locations.

3.2 Method

Participants comprised eleven male partners and one female senior manager. Their average age was 41 years old. The audit partners and a senior manager were key informants employed by the participating audit firms. They were selected on the basis of their formal organizational roles and their depth of knowledge about the participating audit firms (Kumar et al. 1993). The mode of selection was consistent with Kumar et al. (1993) methodology and informants were evaluated on their familiarity and competence to report on the research question. Each of the participating partners had ten or more years' audit experience. The senior manager had eight years audit experience.

The key informants were interviewed³ using an "action research" approach, a method of inquiry that guides action and tackles practical, real world problems (Cassell and Johnson 2006; Dick 1986, 1991). Cassell and Johnson (2006) describe action research as a family of diverse qualitative methodologies to gain understanding of practical social problems. This study uses participatory research that aims to make sense of human reality and give voice to those people or individuals who might be silenced (Cassell and Johnson 2006). The advantage of using action research is the researcher's proximity to real settings, thus reducing the gap between the researcher and the researched, as well as theory and practice (Gummesson 1991). Action research uses collaboration, cooperation and participation based

³ Notes were taken during the first set of interviews however the second set of the interviews were recorded. Just prior to the interviews, the participating auditors were assured of confidentiality and anonymity, hence the interview notes and transcripts are available from the author upon request.

on the principle that involvement generates commitment. French and Bell (1984, 112) argue that “it is a widely held belief that people tend to support what they have helped create”.

The interviews were conducted in the privacy of the auditors’ office or board room. The time for each meeting was approximately an hour to two hours where an unstructured interview was conducted to find out more about the auditor-client management relationship, particularly in relation to professional independence. The helping orientation of action research emphasizes a collaborative process between the participating auditors and the researcher. To engender more openness in the process, the participating auditors were assured of anonymity and confidentiality regarding the sensitive information discussed.

3.3 Results

The interviews revealed that the auditing profession is profoundly affected by the need to ‘win’ and service their clients. For example, one audit partner identified key attributes to be a successful auditor but independence was not mentioned,

“There are a series of attributes we are looking for, obviously things like being technically competent in your particular area of support, that’s one. Getting on well with clients, being able to sell work, getting work is critical, able to win proposals, give presentations, get on well with people. That’s the important part.”

Corporate clients were considered demanding. For example,

“It’s what our clients expect. Some clients will complain if you don’t ring them back within four hours.”

A female senior audit manager described the importance of trust, empathy and respect with some people in the client organization. On the other hand, this interviewee also described auditors as a nuisance to the clients’ business,

“You get to trust and have a level of rapport with some people. ... From another perspective, we are complete nuisances if you like so we have to show a number of

things. Show we understand what they're (*the client*) about. We understand them, their position and their business. We have to show that we understand that we are a nuisance. That you know this is their busy time of the year and we're adding to it. We're part of the busy-ness. We have to show them that. and gain some empathy with them. We have to give them respect as well."

However, one audit partner recognized auditors' humanity. He said that the profession's trust was let down by some client managements' unethical behavior, but auditors were not as skeptical when they should have been,

"Auditors are human Auditors from now on are going to be more cynical when it comes to assessing individuals. I think one of the criticisms of auditors is that they have been too accepting of their representations of management whereby just a little probing would have demonstrated that people didn't deserve our trust."

The interviewed auditors acknowledged that audit conflicts with client management were more prevalent than commonly known. In a number of cases, they recalled audit conflicts which became "screaming matches" between the engagement partner and senior management as the partner verbally fought either to gain the pertinent information, or to ensure comprehensive disclosure. Some auditors recalled incidents where aggressive members of management threatened the auditor. One female senior audit manager described client management abuse,

"He screamed and shouted at me one day. Basically, I was seriously abused."

A male partner described how one of his clients used bullying and threats (verbal force) to pressure the auditor to acquiesce,

"And they threaten you, - the directors are not happy with the actions of that bully ... often you find that if you talk sensibly to someone within the organization with authority that is sensible and responsible and you know the bullying tactics just don't work. I had a situation the other day where another firm had a potential going concern qualification ... they actually said I won't let the auditors qualify our accounts. He (*client management*) said well I don't care what the auditors think. They (*auditors*) just do what I tell them."

Moreover, this audit partner felt he was able to deal with client bullying tactics. “It helps to be 6 foot 4” he quipped. He also indicated that some clients in poor financial condition argue against a ‘going concern’ opinion because client management claim that the auditor will be responsible for the company’s demise.

“I looked at one (*a client*) yesterday that’s not in a very strong financial position and a going concern type qualification is being considered. At the end of the day, if you can’t come to an agreement, the client might use arguments that if you don’t agree well it’ll lead to the demise of the company and all sorts of things like that. Well they are serious issues, there’s no question about it, and you know you could leave yourself exposed to be part of a company falling over you know.”

Further, this particular audit partner warned that,

“Auditors need to be aware of strong CEOs who surround themselves with ‘yes’ people.”

Another male partner commented on the frustration and stress of arguing with some clients in relation to ensuring appropriate disclosure during an audit,

“Sure it can be frustrating. In my situation it gets frustrating. You try and keep on saying no, no, you can’t do that. No you can’t put that there. You can’t record the profit on that transaction. It does become very frustrating. But yeah in some cases it can be very stressful.”

Another interviewed partner argued,

“I think independence is important, but you know there is definitely conflict between trying to see things from the client’s perspective and trying to take an objective stance independent of that. When it boils down to a serious conflict, a lot of it is a question of can we live with it? Do we find the client’s approach acceptable within a range of various alternatives? Can we go with them or not?”

Audit partners agreed that conflicts with client management were often the result of materiality judgments which led to disclosure of sensitive transactions that might affect profit. The materiality level affects the type of opinion which alerts the financial statement users. Deciding upon the actual materiality in a given situation requires professional judgment. The auditor’s materiality decision may affect not only the disclosure of contentious items but also the audit opinion. If management and the auditor do not resolve the conflict,

the auditor may have to qualify their opinion. Professional judgment formation requires internal cognitive processes that are affected by external factors such as client characteristics, for example, the effect of the item on the client's earnings (see Johnson et al. 1989).

The question of how to resolve audit conflicts and remain independent was posed to the interviewed partners. Most of the partners suggested that compromise was a way to resolve an audit conflict with client-management,

“There's the old question about independence because at the end of the day, they (*the client*) pay the bills. They pay the fee ... it's a fine line to walk. Generally if you're confident about something, you'll push for it regardless of the fact that they pay the fees but you can get into the situation where something is border-line and there's an argument ... sometimes you know there might be some giving in to some extent.”

Some of the interviewed auditors suggested that compromise with client management was a reasonable way to resolve audit conflicts. McNair (1991), however, found that audit quality and integrity declined. She found that sociological and ethical ambivalence existed in audit firms where auditors learnt to compromise truthful reporting and integrity, thus trading off audit quality for business considerations. Compromise contradicts auditor independence because there are no degrees in independence; the auditor has integrity, honesty and is either independent or not. Although the interviews revealed serious abuse of auditors by client management, auditors' careers rely on their ability to maintain the client even though the economic power of the client predisposes a challenging relationship, particularly affecting auditors. As one auditor partner said,

“Some people create a situation of ‘don't rock the boat’ for fear of career prospects.”

These action research interviews gave voice to the most senior external auditors of corporate disclosure in their situation of maintaining independent judgment when dealing with powerful client management. These auditors, although in positions of authority within the

large international audit firms, nevertheless expressed feelings of fear, stress, anxiety and ambivalence about giving into a powerful client. Auditors' fear of losing career prospects in a compensation system that is based on attracting and maintaining client fees exacerbates ethical ambivalence described by McNair (1991). The interviews revealed that the audit firms' compensation and reward systems are largely influenced by their client fee base. The engagement partner's ability to attract and retain clients not only impacts on the audit firms' economic well-being, but also on their individual career and personal economic gain (Zeff 2003a). At the same time, engagement partners have an implicit "social contract" to remain independent in the public interest (Mautz 1988; Gaa 1992). The interviews also revealed that audit firms' promotion and reward systems are neither transparent nor open to scrutiny.

This study found that the auditor client-management relationship is emotionally charged particularly when client management has "power over" the auditor (Wartenberg 1990) because an auditors' employment depends on the client company and its management (Goldman and Barlev 1974). Findings also include auditors accusing some managers of bullying, disillusionment about the trust between audit partners and senior managers, auditors' fear of losing career prospects, and the dependency on client fees. These findings also suggest that auditor independence appears to be largely not influenced by the ideal of "scientific attitude" stripped of mental bias (Mautz and Sharaf 1961) or Mautz's (1988) traditional ideal of the profession working in the public interest. Instead, this study finds that auditors' emotions are elicited during auditor client-management relationship particularly when management uses coercion to get their way. In light of these findings, the next section examines the impact of emotions on moral reasoning and auditors' decision-making.

4. Emotions Motivate Moral Reasoning

Research about emotions in the workplace has increased rapidly over the last twenty years or so (see Grandey 2007 for a review), but little research has examined emotions, “an understudied yet powerful contributor to the decision-making process” (Monin et al. 2007, 99; see also Haidt 2007, 2010; Narvaez, 2010). Research about emotions affecting auditors’ judgments has received even less attention since the accounting profession promotes objectivity as a fundamental principle of the profession (Chua 1986; Hines 1991; IFAC, 2005). Moreover, the accounting profession overtly values objectivity and representational faithfulness to service corporate clients who are steeped in instrumental rationality (McPhail 2004). Little research has examined the notion of emotions affecting professional judgment although other auditors’ attributes such as moral reasoning has been extensively investigated (see Bailey et al. 2010). We argue that emotions can motivate moral reasoning particularly when auditors’ decisional processes are first sensitized by a highly intense moral situation.

In this paper we adopt the definition of Frijda and Mesquita (1994, 51) which states that ‘emotions are complex, structured phenomena’ that ‘are affective responses to what happens in the environment and cognitive representations of the event’s meaning for the individual’. Unlike mood and affect, emotions have a specific cause (Frijda 1993; Forgas 1995; Izard 1991; Weiss and Cropanzano 1996). In particular emotions are the result of assessments of situations and, therefore are the product of individual emotional characteristics interacting with environmental characteristics (Hartel and Zerbe 2002).

Many theorists now claim that far from constituting an obstacle to rationality and morality, emotions are both necessary to the proper functioning of theoretical and practical rationality and essential to moral action (Haidt 2007, 2010; Narvaez 2010). Further emotions allow us to

think and act more appropriately, both from the point of view of prudence and ethics (Tappolet, 2009). Greenspan (2009) suggests that a moral code that was not learned in conjunction with emotions would be a serious disadvantage with respect to viability.

A person's emotional abilities and affective traits play a key role in determining one's effectiveness in dealing with the emotional demands of service-oriented work such the auditing (e.g. Saarni 1997; Goleman 1998; Hartel et al. 2002, Bradley et al. 2010). Affective traits appear to act as latent predispositions that help set the stage for individuals to have more or less intense bouts of emotion, in particular, a predisposition to react more strongly to negative events (Weiss and Cropanzano, 1996, 37). Emotions experienced following an event result from the individual's cognitive appraisal of that event (Lazarus, 1966). Therefore an individual's appraisal of events, not the event itself, determines their emotional responses (Roseman et al. 1990). Further an individual's expression of emotion is affected by a number of factors including the emotional contagion of a recent 'service' encounter with a client (Dallimore et al. 2007) and their current situation, the interacting parties, and the emotional climate of the work-group (Hartel et al. 2008).

Though emotions may seem less legitimate than reason as explanations for behavioral choice (Haidt 2001), the recent decision-making literature suggests that emotions may be guiding decisions when people choose the option that they see as least likely to yield guilt (anticipated emotion) or which generates least discomfort at the time of the dilemma (anticipatory emotion, see Loewenstein et al. 2001). Sometimes strong emotions arise from being torn between the options (Tetlock et al. 2000) leading some to avoid the decision altogether in order to overcome this aversive state (Anderson 2003). Lerner and Keltner

(2001) showed that fearful individuals favor safer options, whereas anger leads people to take more risks.

Recently, the debate about the primacy of emotions over reason affecting judgment has been of particular interest to researchers of moral psychology (Monin et al. 2007; Haidt, 2007, 2010; Narvaez, 2010). Monin et al. (2007) discuss the philosophies underlying the emotion reason debate. Hume (1777 cited Monin et al. 2007) argued that emotions guide reasoning, whereas Kant (1785/1993 cited Monin et al. 2007) maintained that reason governed moral judgment mainly in reaction to Hume. “But can we really make sense of ‘respect for the moral law’ apart from our understanding of the empirical world of so called ‘pathological’ emotions?” (Neu 2009, 502).

Kant’s philosophy does emphasize socio-deontological rationality and underpins Kohlberg’s theory (1969) of moral reasoning. Prinz (2009) suggests that emotions play an important role in motivating moral behavior. Some researchers (e.g. Haidt 2001, 2007, 2010) argue that emotions play a primary causal role in moral decision-making whereas other researchers have defended higher order reasoning as a important causal determinant of moral reasoning (Pizarro and Bloom 2003 cited Monin et al. 2007). Monin et al. (2007) analyzed both approaches and found that those researchers who support higher order reasoning as a determinant of moral decision-making relied upon sophisticated dilemmas such as those devised by Kohlberg (1969); whereas researchers of the emotion/intuitive approach examined reactions to other people’s ethical breaches such as Haidt’s (2001) reference to incest.

If the typical moral situation is viewed as the resolution of a moral dilemma then a model of moral judgment that includes rational deliberation will be appropriate. If, on the other hand,

the typical moral situation is perceived as judging others' moral infractions, morality may involve quick judgments that have a strong affective component and are not necessarily justifiable by reasoning. Monin et al. (2007) argue that both approaches can be useful but the applicability depends upon the situation or context.

The auditors' complex decision-making model (Figure 1) posits that situational context is critical to the decision-making process and outcomes. In this instance, simple and less morally intense situations trigger auditors' emotional processes for an immediate intuitive response (Haidt 2001, 2007, 2010). When a morally intense situation sensitizes more complex decisional processing, emotions elicited from such an encounter motivates deliberative reasoning accessing auditors' levels of moral reasoning. In effect, emotions regulate and also motivate higher moral decision-making processes in a morally intense situation.

4.1 Propositions

The auditor-client management relationship has 'power over' auditors' independence judgments (Wartenberg, 1990; McCracken et al., 2008). The qualitative study found that auditors' emotions are elicited in this morally charged relationship exacerbated by a flawed regulatory structure where the auditee company is also the client. Earlier research found that principled auditors activated their high moral reasoning to resist management threats in a hypothetical audit conflict, thus maintaining their independence. Other auditors with lesser or mid moral reasoning tend to accommodate client management to please those in power and compromise their professionalism. Some auditors with low moral reasoning make judgments based on their self-interest – what's in it for them. In this study we propose that the context where the power of client management pressure exacerbates situational moral intensity

sensitizes auditors' emotions that motivate moral reasoning, thus affecting auditors' professional judgments denoting moral character.

A recent view of morality emerged which is consistent with Hume's (1969 cited Monin et al. 2007) emotionalist vision, different to the Kantian rationalism of Kohlberg and his followers. This view suggests that emotions are the primary causes of moral judgment and behavior that moral judgments often arrive in the form of quick, affect-laden moral intuitions where intuitions are behavioral guides or evaluations that directly follow from an emotional experience (Haidt 2001, 2002, 2010). In some instances even where respondents have no rational defense for their position they still hold on to it, described by Haidt (2001) as 'moral dumbfounding'.

Haidt (2010) argues that a strong link exists between moral emotions, moral reasoning and moral action. He further argues that emotion or intuitive gut feeling is like an unconscious heuristic that helps immediate moral action by anchoring onto a self-evident truth or judging moral infractions in one step. We agree with Haidt (2001, 2002, 2007, 2010) to some extent that emotion is an intuitive 'gut feeling' but in low moral intense situations. We argue however that emotions motivate moral reasoning by regulating ego (Monin et al. 2007) when persons are faced with a more complex situation of high moral intensity that requires deliberation (Narvaez 2010). As shown in Figure 1, auditors' responses at level 1 are impressionistic and intuitive (Haidt 2001, 2007, 2010), an immediate reaction to low level situational contingencies. At this level decisions are made immediately without the need for deliberative thought about alternatives as in the case of more morally intense situations (Narvaez 2010).

When the situation is more complicated and morally intensive (Jones 1991) such as an independence judgment involving powerful client management economic threats, the emotional response in level 1 motivates moral reasoning at level 2. We propose however, that auditors' decision-making will be affected by their level of moral reasoning as outlined in Table 1. The following proposition reflects these arguments.

4.1.1 Proposition 1, Post Conventional Reasoning and Emotions

We propose that a morally intensive situation will first sensitize auditors' emotions that motivate post conventional or high moral reasoning as well as regulating ego and self interest. These auditors will be more likely to resist client management economic pressure thus demonstrating principled moral character. Evidence from the psychology literature indicates the emotions regulate ego, self gratification and willpower to resist temptation (see Monin et al. 2007). Further, emotions in social and economic interactions promote the fulfillment and enforcement of social and moral obligations by overriding the person's material self-interests (Pham 2007).

The emotions such as anger motivates high moral reasoning predisposing these auditors to not only restrain their ego but activate deliberative reasoning to resist temptation and forgo easy short term rewards offered by client management for broader, social long term rewards in line with their strong moral character necessary for professional obligations to society.

Narvaez (2010, 169) describes deliberation as part of the complexities of reasoning,

“Deliberation permits one to step back from the current flow of events to consider additional information and alternative cues, facts, and paths from those to which one first attends. ... Deliberation is often a matter of shifting between reasoning and intuition, principles and goals, and values and abilities as one weighs options and monitors goals and reactions.”

This moral deliberative and structured thinking requires mature moral functioning that comprises multiple skills and capacities, including the capacity for emotional regulation, ongoing self-development based on a virtuous life, having a moral imagination, and high moral intelligence (Narvaez 2010).

Haidt (2002) further argues that anger is one of the most undervalued moral emotions evoking injustice and immorality that activate prosocial motives and actions. The interviews revealed that some auditors were angered by aggressive client management's verbal abuse, demanding compliance to client demands. These theoretical and empirical observations suggest the following proposition:

Proposition 1: In situations of high moral intensity involving client management economic pressure, principled auditors are more likely to be morally sensitized, feeling emotions such as anger that will motivate high moral reasoning using deliberative decision-making to resist client management unethical demands.

4.1.2 Proposition 2, Pre-Conventional Reasoning and Emotions

Auditors with pre-conventional reasoning or low moral reasoners will be the least affected by emotions because evidence suggests they lack empathy or the capacity to feel for others. Furthermore, these auditors' egos have such a pervasive influence over their decisions involving other people that these auditors care only about themselves and their self-interest (see Kohlberg 1969; Rest 1979; Rest et al. 199). Evidence also suggests that the self-interest predisposition of pre-conventional thinkers is more likely to elicit psychopathic tendencies. For example, Haidt (2002) argues that the self-interested individual or 'Homo economicus' resembles a psychopath as the following indicates,

“A more relevant heuristic is to imagine a perfectly selfish creature, the mythical Homo economicus, who cares only about their own well-being and who cooperates with others only to the extent that they expect a positive net payoff from the transaction. Homo economicus may experience negative affect when some resource is

taken away from them; but they would retaliate only if they thought that the benefits of retaliation outweighed the costs.

And they would have no affective reactions when good or bad things happened to other people. An alternative definition of the moral emotions can therefore be stated as the difference between the emotional life of Homo sapiens and the emotional life of Homo economicus ...who resembles a psychopath” (Haidt 2002, 854-5).

To service their corporate clientele, the large accounting firms want “employees who are energetic, charming and fast moving” (Boddy et al. 2010). Psychopaths can present themselves in a distinctly positive way particularly during interviews thus giving an appealing impression to employers. Boddy et al. (2010) maintain that psychopaths appear to be alert, highly intelligent, funny, friendly and easy to get along with and talk to. Further they appear to have “good ability, emotionally well-adjusted and reasonable” evoking loyalty from others that is not reciprocated (Boddy et al. 2010). Psychopaths through manipulative charm and strategic networks can quickly be promoted to the senior levels, shedding redundant patrons and making new alliances (Wexler 2008). Babiak and Hare (2006) highlight in their research that “the corporate psychopath’s skills at extracting personal gain, running sophisticated scams and fox-like ability to strategically shift alliances all of which are sought and rewarded in the modern organization. ... Despite their position as leaders, they are not particularly socialized to work on behalf of the organization as a whole” (cited Wexler 2008, 228).

Psychopath’s strategic and methodical rise is supported by a “polished and unemotional decisiveness” that can make them look like “ideal leaders” (McCormick and Burch 2005) when in fact psychopaths are driven by their ego and self interest using people as a means to end, to gain power. To ensure career and economic success psychopathic auditors are likely accede to or even support client management perpetrating accounting fraud to maintain that client rather than caring about their professional obligations of independence. Research

shows that psychopaths know right from wrong but don't care (Cima et al. 2010). We therefore argue that the self interest or low moral reasoning auditors predisposes them to a psychopathic tendency, unable to care enough to react to good or bad when dealing with powerful client management. This suggests the following proposition:

Proposition 2: In situations of high moral intensity involving client management economic pressure, pre-conventional reasoning auditors will less likely feel emotions, thus moral reasoning will not be sensitized; hence these auditors are more likely to pragmatically accede to management's demands only if it suits these auditors' egoistic self-interest.

4.1.3 Proposition 3, Conventional Moral Reasoning and Emotions

Earlier experiments found that the conventional or mid moral reasoning auditors are more likely to accede client management (Windsor and Ashkanasy 1995; Windsor and Warming Rasmussen 2009) because they trust those in authority in this case, client management, the provider of their employment (see Kohlberg 1969, 1986). As one interviewed partner said,

“I think one of the criticisms of auditors is that they have been too accepting of their representations of management whereby just a little probing would have demonstrated that people didn't deserve our trust.”

People with conventional moral reasoning have been found to uncritically follow those in authority (Kohlberg 1969; Rest 1979; Rest et al. 1999). In fact, one of the interviewed partners revealed auditors' had trusted management thus leading to a lack of professional skepticism when some corporate management had clearly behaved unethically.

Fear is another emotion that may affect conventional reasoners' decision-making. For example, another partner suggested in the interviews that some auditors accepted the status quo (don't rock the boat) for fear of losing career prospects because auditors are rewarded for attracting corporate clients and associated fees (Mautz and Sharaf 1961) rather than independent judgments. In low moral intense situations though, conventional auditors would follow the rules and the auditing standards performing their tasks competently and professionally. Conventional thinking auditors when under intense moral pressure though

would be less critical or skeptical of powerful authority, in this case client corporate management. Hence the conventional auditors' uncritically trust client management suggests they are more likely to accommodate client management demands clouding moral sensitivity in morally intense situations. These theoretical observations suggest the following proposition:

Proposition 3a: In situations of high moral intensity involving client management economic pressure conventional reasoning auditors are more likely to feel emotions such as uncritical trust of client management that cloud moral sensitivity, hence these auditors are more likely to accommodate management's demands to maintain the status quo.

Proposition 3b: In situations of high moral intensity involving client management economic pressure conventional reasoning auditors are more likely to fear client management hence these auditors are more likely to accommodate management's demands.

5. Conclusion

An auditor's independent opinion is supposed to be emotionally detached and objective to verify corporate financial statement in their regulatory oversight role of corporate financial reporting (Mautz and Sharaf 1961; IFAC 2005). Yet auditors employed by large accounting firms are economically dependent on the very companies that they are required to provide an independent verification of financial information in the public interest. Auditors however are human subject to a full range of emotional and personality characteristics that respond to powerful social and economic forces in the form of corporate management. This study posits a model of auditors' complex decision-making comprising situational moral intensity, and auditors' personal attributes of emotions and moral reasoning outlines in Figure 1. The situational moral intensity is reflected in the auditor-client management relationship where client corporate management has "power over" the auditor that inherently challenges auditor independence (Wartenberg 1990). A qualitative study reveals auditors' views and feelings about their experiences involving auditor-client management relationship including various emotions such as fear, trust and anxiety.

All elements of the auditors' complex decision-making model explore the understudied emotions as an important contributor to auditors' decision-making. We propose that a high level of situational moral intensity, in this case the client management's overt economic power sensitizes auditors' emotions that motivate their higher levels of moral reasoning (post-conventional and conventional) to deliberate a decision to accede or resist the client's unethical demands. In contrast, pre-conventional auditors are less likely to feel any emotions thus not triggering higher levels of moral reasoning; hence these auditors will accede to client wishes when it suits their self interest. In effect, pre-conventional reasoners are likely to have psychopathic tendencies and lack feeling when making professional decisions that have wider societal implications.

Auditors have a professional responsibility to ensure the honesty of corporate financial reports, fundamental to the well-being of a capitalistic society. The collapse of Lehman Brothers however resulted in widespread community social and economic harm triggering the near collapse of the international financial system that operates on the public trust. The Lehman Brothers' collapse suggests that their auditors were more (self)-interested in keeping their client happy (McCracken et al. 2008) fees for services that included advice to manipulate the accounts giving a favorable appearance to the public rather than providing an independent verification and exposing Lehman Brothers' real financial position.

Ashkanasy et al. (2006) found that the organizational reward system implemented by senior management influences subordinates to act unethically to comply or cover management malfeasance. Organizational reward systems controlled and implemented by senior management affects employees' decision-making by influencing their outcome expectancies.

Further their findings indicate that that “organizations should look for high CMD (*moral reasoning*), high BJW (*beliefs in a just world*) managers for positions of responsibility. They will then be the ones responsible for designing the reward system that will guide others” (Ashkanasy et al. 2006, 468). Similarly the large international professional services firms that employ accountant auditors should also ensure their senior partners have a principled moral character to implement and monitor a reward system that encourages ethical behavior throughout.

The challenge for the accounting profession is how to inculcate appropriate ethical values to members who work in loose network structure that in effect has many senior level partners in charge of many and various offices or franchises spread over several national and international locations. The advantage of the loose networks is the local partners’ response of flexible and localized service to suit clients, however the inculcation, monitoring and oversight of an organizational wide ethical culture becomes difficult, perhaps impossible as in case of Arthur Andersen.

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Table I
Kohlberg's Six Stages of Moral Reasoning

Pre-Conventional Level

Focus is self.

- Stage 1: Obedience: You do what you are told primarily to avoid punishment.
 Stage 2: Instrumental egotism and simple exchange: Let's make a deal or only consider the costs and/or benefits to oneself.

Conventional Level

Focus is relationships.

- Stage 3: Interpersonal concordance: Be considerate, nice and kind and you'll get along with people. Focus is on co-operation with those in your environment.
 Stage 4: Law and duty to the social order: Everyone in society is obligated and is protected by the law. Focus is on co-operation with society in general.

Post-Conventional Level

Focus is personally held principles.

- Stage 5: Societal consensus: You are obligated by whatever arrangements are agreed to and by due process and procedure. Focus is on fairness of the law or rule as determined by equity and equality in the process of developing the rule.
 Stage 6: Non-arbitrary social co-operation: Rational and impartial people would view co-operation as moral. Focus is on fairness of the law or rules derived from general principles of just and right as determined by rational people.

Source: Adapted from J. Rest (1979)

Figure 1. Auditors' Complex Decision-Making

