

SECOND-PARTNER REVIEW: A NEGOTIATION PROCESS PERSPECTIVE

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ABSTRACT

This paper synthesized the behavioral negotiation literature to develop a model incorporating the features of the accounting setting in second partner review. The model was used to create a questionnaire to be given to partners in public accounting firms, experienced in doing such second partner reviews. The questionnaire covered the elements, associations and contextual features surrounding the second partner review process. Analysis of the responses provides a comprehensive picture of a typical second partner review; the types of issues involved, the nature of the process itself, and the types of outcomes that may result. The results describe a professional, collegial, non-adversarial process, primarily focused on the objective of resolving difficult and complex client accounting issues. The ultimate resolution of the issue giving rise to the interaction is a reflection of the suggestions of the reviewing partner, the engagement partner and often is a new and synergistic solution that is more than either of the two alone.

INTRODUCTION

The purpose of this paper is to systematically examine, and provide insights into, the second partner review process. More specifically, we focus on reviews where the process includes direct interaction between the review partner and the engagement partner in order to resolve a question or questions that arise in the course of the review.

BACKGROUND TO THE NEGOTIATION MODEL

The basic negotiation model consists of three components [6], [7], [8]. The first component is the *issue*, which may be “new” but often exists in the context of past negotiations and relationships between the negotiating parties [2]. The second is the *process* which consists of various choices and actions, and the third is the *outcome* which may be unidimensional or multidimensional. The model is temporally interconnected – even if the issue changes from one negotiation to another, the result of prior negotiations may be part of the context of the issue in the subsequent negotiation.

The Accounting and Auditing Environmental Context

The importance of second partner review has been emphasized by recent events within, and outside, the profession. Externally, legislators and regulators have enacted new regulations requiring that the partner performing the review be rotated [9]. Internally, Quality Control guidelines explicitly identify second partner review as an important part of the quality control process ([1], [4], [5]).

THE RESEARCH QUESTIONNAIRE

Questionnaire Design

The instrument was adapted from [6], who used a structured questionnaire approach adapted from the negotiation models of cognitive and social psychology to examine auditor-client negotiation concerning the client's financial reporting. Their original questionnaire was revised to fit the context of internal interaction between review partner and engagement partner. Senior partners in US and Canadian offices of the four major international accounting firms participated in the study.

RESULTS AND ANALYSIS

Demographic Information

There were a total of 127 respondents, 86 from offices in the U.S. and 41 from offices in Canada. The mean length of public practice experience of the respondents was 30.22 years (S.D. = 8.95 years). The mean number of engagements on which they had fulfilled the function of review partner in the last five years was 21.46 (S.D. = 10.03). In their estimation, about 20 percent (S.D. = 9.00 percent) of reviews result in the identification of an issue that requires discussion with the engagement partner to resolve.

The Issue

The large majority of participants' recalled examples (ninety-five percent) arose from the audits of publicly-listed companies. The other five percent were from audits of not-for-profit entities. In general the examples arose from relatively recent audits of longer-tenure clients. Approximately ninety percent of the examples related to clients of three or more years, and approximately two-thirds of the examples had occurred within the last year.

Forty-six percent of the partners reported that the negotiation resulted from the complexity of the issue. The next most common reason identified (thirty-seven percent) as the reason for the negotiation was the materiality or significance of the issue. Rounding out the reasons chosen, seventeen percent of the respondents reported that the negotiation arose from disagreement with the engagement partner on how to resolve an identified issue in the financial statements. None of the respondents chose the alternative, "External rules and regulations", or chose the open-ended alternative, "Other", at the end of the question.

The Process

The most common accounting-related implication of the chosen examples was income recognition or measurement (35 percent). Income measurement was the trigger issue in the scandals that rocked the public accounting profession and it is not surprising that review partners would be sensitized to that area. The next most commonly-chosen implication (at 31 percent) was related to Financial Statement disclosure and the third (at 24 percent) related to valuation. In the every instance, the respondent indicated that the chosen example had some accounting or disclosure implication.

By contrast, only a minority of the identified issues were auditing related. Of the auditing-related implications that were identified by the respondents (only 34 percent of the total), 41 percent listed concerns about sufficient appropriate audit evidence as the major audit implication, and 59 percent indicated that the issue giving rise to the negotiation was related to the proposed treatment of errors identified in the course of the audit.

The Outcome

Going into the process, all of the respondents believed that a mutually agreeable solution could be reached – at the end of the process that mutually agreeable solution took one of several forms. In 24 percent of the examples the resolution of the issue was agreement with the engagement partner’s initial position, while an almost equal proportion, 21 percent, of the issues were resolved in agreement with the review partner’s initial position. Sixteen percent of the time, the resolution was a compromise between the initial positions of the review partner and engagement partner. The most frequent response at 39 percent was that the resolution resulted in agreement on a new solution generated by the discussion between the engagement partner and review partner. Thus a majority of the reported examples ended in what would be characterized as an integrative solution rather than a distributive solution where one side prevails over the other side [3]. This may also be contrasted with the results of [6] who found that in auditor-client negotiations, resolution resulting in a “new” solution was the least common result and compromise between the positions of the auditor and client were the most common outcome.

DISCUSSION AND CONCLUSION

This paper has used a perspective drawn from the negotiation literature to examine second partner review in professional auditing firms. In conclusion, the perception of the partners in this study is that the second partner review process is a collaborative process where the objective is to ensure that the audit has been complete, that there are no unresolved accounting issues and that the final audited financial statements satisfy professional standards and legal and ethical requirements.

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