

The Alumni Effect: Lack of Professional Skepticism or Source Credibility

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A major concern of regulators such as the SEC is the potential impairment of independence, and consequently, impairment of professional skepticism, of external auditors. This has resulted in a number of regulations regarding the relationships between auditors and their clients. Of particular concern in this paper are the restrictions on the employment of previous audit partners in a senior financial management capacity by a continuing audit client. It is considered by some that these restrictions may have created a conflict between independence and expertise. This paper reports the results of a study that experimentally examined whether auditors are more likely to have their judgments influenced by/to accept client explanations when the client representative providing those explanations is a former audit partner of the auditor's firm and seeks to shed light on whether such influence may be due to the auditor's reduced professional skepticism or due to the perceived increased expertise of the client senior financial management.

The participants were presented with a scenario in which they, as the current auditor, were asked to discuss with the client's senior financial officer (CFO), the potential impairment of goodwill on the client's financial statements. There was information pro and con the recognition of impairment, requiring the participant to exercise professional judgment. The identity of the client's senior financial officer was manipulated to be either a former audit partner of the firm who worked on that client's audit (FAP), a former audit partner of another Big 4 firm, or an individual whose previous experience was not explicitly specified. The results of the experiment showed that when arguments for considering goodwill to be not impaired were provided by a FAP, the current auditor more frequently accepted them, although the frequency of acceptance was almost as high when the arguments for considering goodwill to be not impaired were provided by an audit partner from another Big 4 firm. The participants' level of judgment confidence in that acceptance was similar whether the explanation was provided by a former audit partner of the same firm or by a former audit partner of a different firm, and both were higher than in the condition where the explanation was provided by a CFO who had no affiliation with the auditors or another audit firm.

Taken together, the results regarding frequency and confidence suggest that the increased propensity of the current auditor to accept the arguments of the CFO, while consistent with reduced professional skepticism, can also be construed as being a function source credibility. The CFO identified as either the former audit engagement partner or a former audit partner from another firm would be considered, because of his or her greater expertise, to be a more credible source.