
Aspects Regarding the Auditor- Auditee Relationship in the Context of Negotiation

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Abstract

This paper aims to examine how the relationship between the auditor and the auditee influences the negotiation strategies and also the study of the link between variables related to the relationship between the auditor and the auditee in the negotiation process during the audit engagement. Based on the literature and the working tool (questionnaire), it was possible to demonstrate that the auditor-auditee relationship is a key factor in establishing negotiation strategies between auditors and clients.

The bivariate analysis performed in the paper consolidate the research of the specialized literature and confirm the existence of a link between the auditor-auditee relationship/familiarity in the implementation of all the negotiation strategies during the audit mission.

Keywords: auditor-auditee negotiation, auditor-auditee relationship, familiarity, audit mission, mutual interest.

JEL Classification: M42

To cite this article:

Bunget, O.C., Tiron Tudor, A., Sumănar, A.D. (2019), Aspects Regarding the Auditor-Auditee Relationship in the Context of Negotiation, *Audit Financiar*, vol. XVII, no. 2(154)/2019, pp.247-260, DOI: 10.20869/AUDITF/2019/154/008

To link this article:

<http://dx.doi.org/10.20869/AUDITF/2019/154/008>
Received: 4.12.2018
Revised: 28.02.2019
Accepted: 19.03.2019

1. Introduction

The subject of this research is the application of a questionnaire containing elements related to the auditor-auditee relationship / familiarity and the negotiation in the financial audit. On the basis of the obtained answers, we carried out univariate and bivariate analysis of the data in order to identify a possible link between the relationship, implicit auditor-auditee familiarity and negotiation between these parties.

In order to present the current state of this research, first of all it is necessary to present the concepts of auditor-auditee relationship and negotiation.

The auditor-client relationship and how auditors interact with clients is presented and exposed by the IAASB, "Audit Quality Framework." The framework also demonstrates the importance of appropriate stakeholder interactions and the importance of different contextual factors.

The way in which the parties interact and the degree of proximity between them is of major importance in the conduct of the audit engagement in the opinion of the auditors, since this appropriation / familiarity between the parties influences how the choice of negotiation and decision-making strategies by auditors. According to the Ethical Code of Professional Accountants, edition 2013, developed by the International Accounting Standards Board (IESBA) of the International Federation of Accountants (IFAC), applicable by Romanian financial auditors, members of the Chamber of Financial Auditors in Romania, the term 'familiarity' is the threat that, owing to a too long or too tight relationship with a client or an employer, a financial auditor may be too lenient with their interests or acceptance of their activity.

An open and constructive relationship between the auditor and management should be different from an overly familiarity that may arise between auditors who spend extended periods throughout the year at the same audit client.

It is essential for the quality of the audit that auditors remain skeptical and objective and be prepared to question the reliability of the information they receive. According to IAASB, threats to the independence of the auditor may include, in most cases, the financial interests between the auditor and the audited entity, the business relationship between the auditor and the audited entity and the provision of non-audit services to audit clients.

Murnighan and Bazerman (1990) consider that negotiation is "any context in which two or more parties with different preferences together take decisions that affect the well-being of both parties." Moreover, according to Pruitt and Carnevale (1993), negotiation is mainly an interaction between two or more actors wishing to resolve disagreements due to conflicts of interest.

Despite the variety of negotiation definitions, researchers share common concepts around negotiations, especially all theories emphasize that actors believe negotiation allows them to achieve better results.

This paper analyzes the auditor-client relationship in the context of negotiations initiated by the auditors during the financial audit mission.

The aim of this research is to study how the negotiation-specific approach is influenced by the relationship, i.e. the familiarity between the auditor and the client.

Throughout the paper, the phrase "auditor-audited relationship" is used under the connotations of familiarity.

This "familiarity" is often encountered in practice. This is why we want an analysis of how this familiarity influences how the parties are negotiating.

The relationship between auditors and auditees and negotiating power have been recognized by both the researchers and the practitioners as important elements for bargaining strategies. However, to date there has been little effort to study empirically or theoretically the effect of these factors in the context of auditors' negotiation with customers.

This paper focuses on the auditor-auditee relationship in the context of negotiations that auditors can follow when solving accounting problems. In essence, the aim of this research was to study how the negotiation-specific approach is influenced by the relationship, implicitly the familiarity between the auditor and the auditee.

2. Literature review

Auditors often find themselves in situations where they need to negotiate with their clients on controversial accounting items for which the accounting standards are vague (Peecher, 1996). Customers could use this vague interpretation of standards to justify aggressive accounting alternatives (Nelson et al., 2002). In general,

auditors express reluctance with such managerial strategies and this attitude constrains their actions for fear of receiving unsatisfactory opinions. For example, auditors sometimes approve the auditee's alternative to maintain their auditor-auditee relationship, though this will more likely increase their exposure to litigation. This controversial situation suggests that both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options (Antle and Nalebuff, 1991; Gibbins et al., 2001).

The auditor's report and the financial statements are therefore considered to be common auditor and management products (Antle and Nalebuff, 1991), although the final responsibility for the financial statements and the related disclosures remain at the head of the reporting company. When an accounting adjustment is required, it will be "reserved" or the disclosure will only be made if the auditor successfully convinces the management to approve the proposed adjustment or disclosure. Thus, the auditor-auditee relationship is described as a "broad bargaining system" (Murnighan and Bazerman, 1990).

Negotiating adjustments may harm investors or any other interested party that relies on the potentially distorted financial reports for decision-making, which could lead to public conflicts.

When auditor negotiation strategies fail to convince a difficult client and no mutually acceptable position is reached, the auditors are confronted with the potential loss of a client if they retain their land or increase their reputational risk if they meet the client's requirements. Research has shown that choosing the negotiation strategy, given the different audit circumstances, has an effect on the outcome of the negotiations. In this respect, choosing the auditor's negotiating strategy becomes very important in view of its potential impact on the financial statements, the auditor's reputation and professional survival (Gibbins et al., 2001; Johnstone and Muzatko, 2002).

3. Research methodology

This study is based on the elaboration of a questionnaire consisting of 11 questions in which there are quantitative and qualitative factors associated to the auditor-auditee relationship. The first part of the questionnaire includes general information on gender, age, profession and experience in the profession of financial auditor.

The second part of the questionnaire includes aspects of the auditor-auditee relationship.

This paper aims to analyze the link between the variables regarding the relationship between the auditor and the auditee based on respondents' answers.

Familiarity between the auditor and the client influences:

- The terms of the audit contract in the interest of both parties.
- The auditor's choice of the type of procedures used during the audit engagement.
- The auditor's professional judgment regarding the materiality threshold calculation.
- Conflict of interest, when, the auditor sometimes approves the client's alternative to maintain the contract, although this will increase his exposure to public conflicts and litigation.
- Mutual interest of both the auditor and the client in negotiating from several acceptable reporting options.

The questions from the questionnaire are closed questions, thus ensuring the timely completion of the questionnaire and the possibility of creating a database with a limited number of clearly defined variables.

4. Results of the study

4.1. Sample Description

On the basis of the questionnaire, there were obtained answers from 51 respondents, having the quality of either students who studying master in accounting / auditing, or active financial auditors, members of the Chamber of Financial Auditors of Romania, Cluj County, or having both qualities with a varied experience in the field.

The responses of the 51 validated questionnaires were entered into a database of SPSS Statistics 17.0, each of the factors included in the questionnaire representing a variable of the prepared database. We opted for the SPSS statistical program, as we considered it to be superior to other statistical programs in such research (Intercooled State, E-VIEWS, etc.).

In the following it is presented the analysis of the socio-cultural factors, namely gender, age, profession and experience in the profession (Tables no. 1, 2, 3 & 4).

Table no. 1. Sex Representation

Sex	Absolute Frequency	Relative Frequency (%)
Female	39	76,5
Male	12	23,5
Total	51	100

Source: Own projection

Of the respondents, the female sex is representing 76.5% and the male - 23.5%.

Table no. 2. Age representation

Age	Absolute Frequency	Relative Frequency (%)
younger than 25 years old	31	60,78
25-35 years old	14	27,45
35-45 years old	1	1,96
45-55 years old	3	5,88
55-65 years old	2	3,92
Total	51	100

Source: Own projection

Respondents are under the age of 25, respectively between 25-65 years old.

Table no. 3. Representation of the profession

Profession	Absolute Frequency	Relative Frequency (%)
Student	1	1,96
Student mastering in accounting / audit	29	56,86
Financial auditor	21	41,18
Total	51	100

Source: Own projection

Regarding the profession, most of the respondents are master students in accounting / auditing. These account for 56.86%, and

financial auditors account for 41.18% of the total sample analyzed. Also, among the respondents there is also a bachelor student.

Table no. 4. Representation of experience in the profession

Experience as a financial auditor	Absolute Frequency	Relative Frequency (%)
No experience	26	52
1-5 years old	18	36
5-10 years old	3	6
10-15 years old	2	4
Over 15 years old	1	2
Total	50	100

Source: Own projection

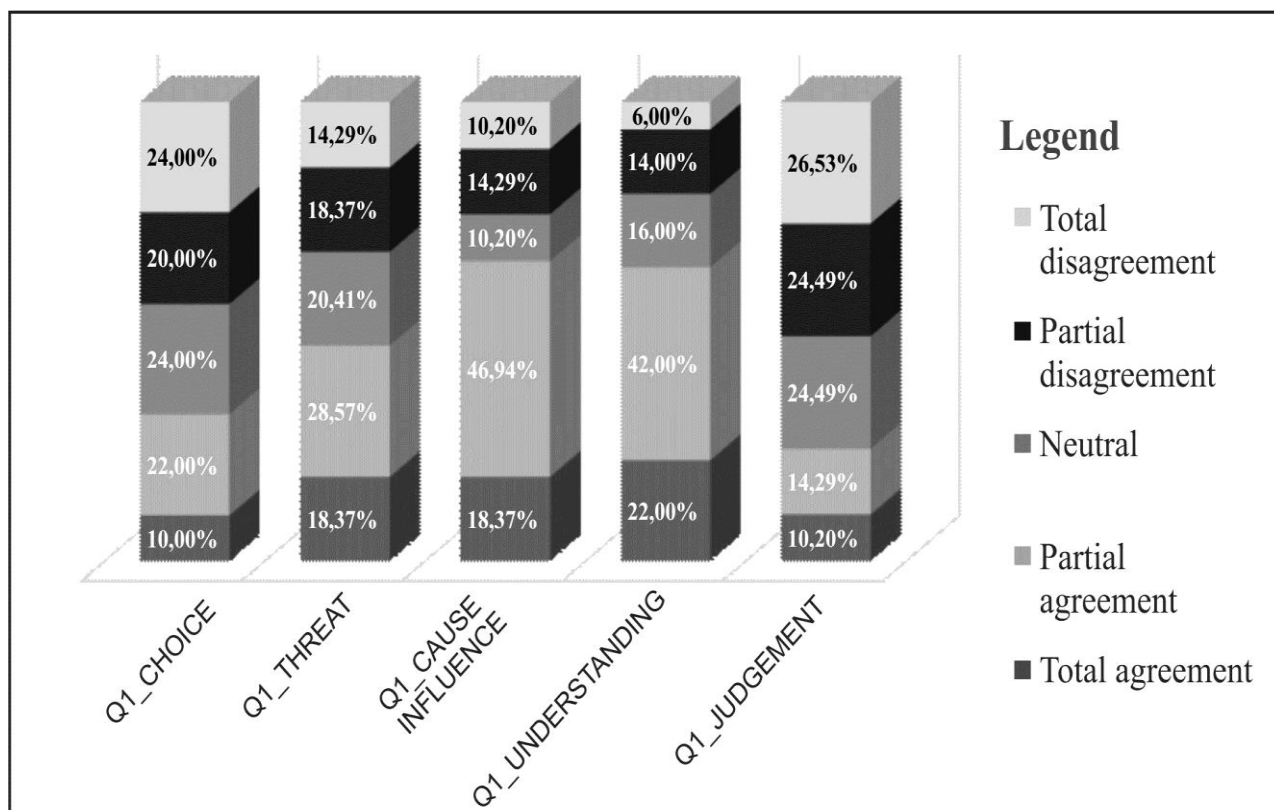
Of the total respondents, the inexperienced ones account for 52%, and the experienced ones for 48%.

4.2. Univariate analysis

The univariate data analysis aims to apply statistical

and mathematical techniques for studying the population under investigation, depending on a single variable. The univariate analysis process refers, in particular, to the calculation of frequency (absolute and relative).

Figure no. 1. Familiarity between the auditor and the auditee



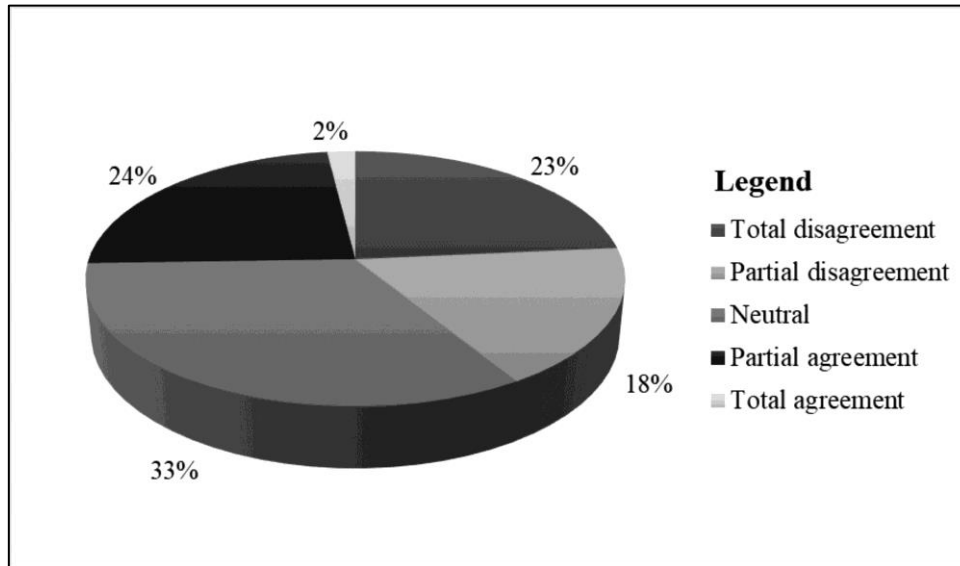
Source: Own processing

Based on the responses received, from **Figure no. 1** we infer that the familiarity between the auditor and the auditee influences the terms of the audit contract in the interests of both parties (65.31% of the respondents expressed their agreement – in whole or in part – with this statement). On the other hand, the familiarity between the auditor and the auditee is necessary for the auditor to understand the auditee well enough to plan and perform an effective audit (62% of the respondents

expressed their agreement – wholly or partly – about this statement).

- I. The auditor sometimes approves the auditee’s option to maintain the auditor-auditee relationship, although this will increase his exposure to public conflicts and litigation (**Figure no. 2**).

Figure no. 2. Auditee's Alternative

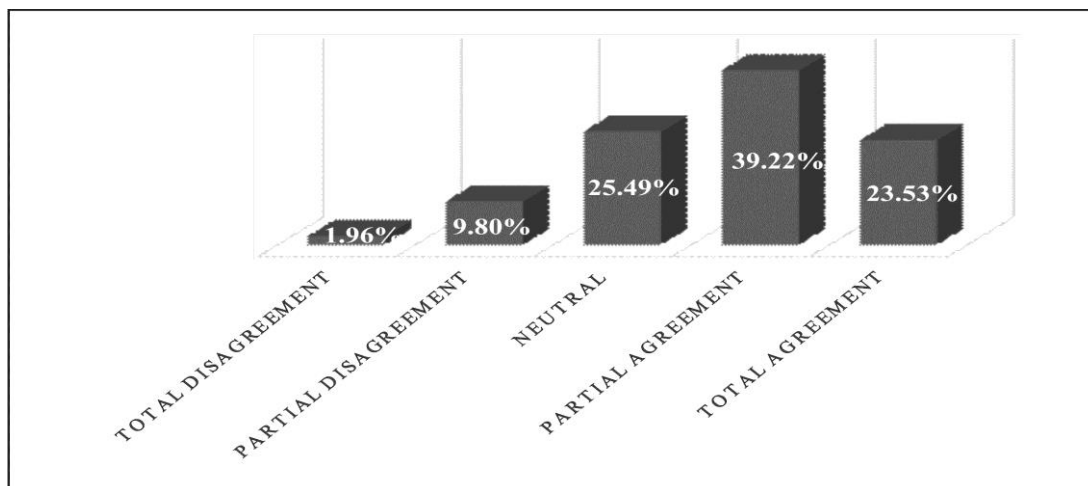


Source: Own processing

In this case, among respondents, opinions are divided. Using the Hi-square test to study the uniformity of the sample, it is found that the sample has the same structure in relation to the analyzed variable (the significance level being $0.009 < 0.005$, the null hypothesis that the distribution of the sample follows the uniform probability law is accepted).

II. The more audacious the audited financial statements, the less exposure to litigation or public conflicts. Conservatism reflects the application of the prudence principle, namely, assets and income are not overvalued and liabilities and expenses are not underestimated (Figure no. 3).

Figure no. 3. Conservatism of Financial Statements

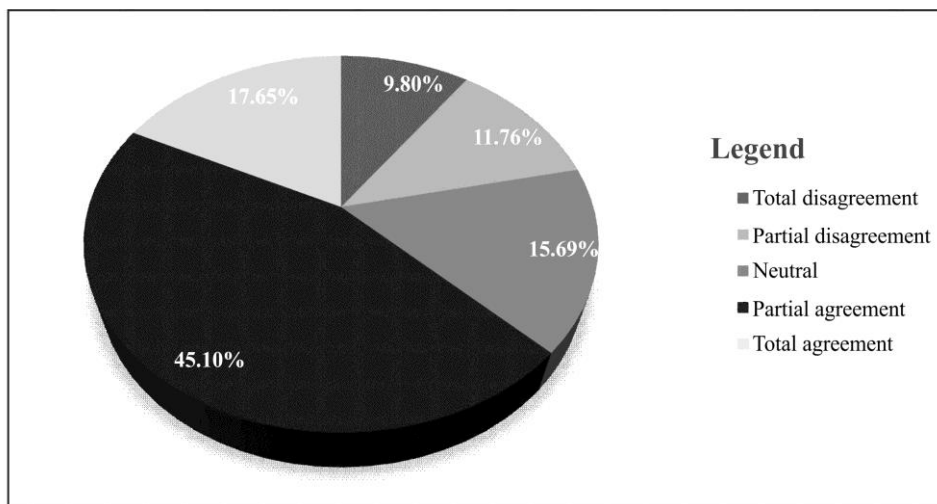


Source: Own processing

A total of 62.75% of respondents agree with this statement. *The principle of prudence* applies in accounting conservatism.

III. Both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options.

Figure no. 4. Mutual interest for negotiation

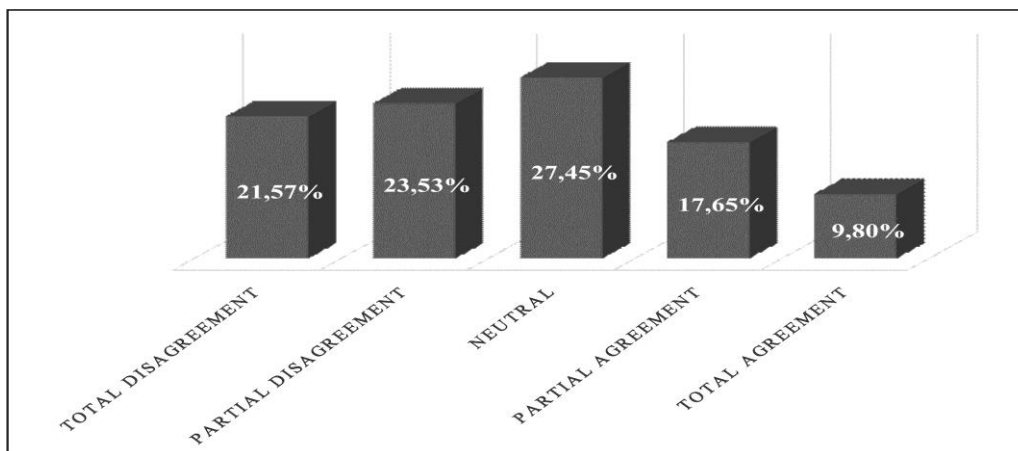


Source: Own processing

From the **Figure no. 4**, we find out that most of the respondents also agree with this statement, the rest having different opinions.

IV. When an accounting adjustment is required, disclosure shall be made only if the auditor is satisfied with the management's approval of the proposed adjustment (**Figure no. 5**).

Figure no. 5. Need for accounting adjustments

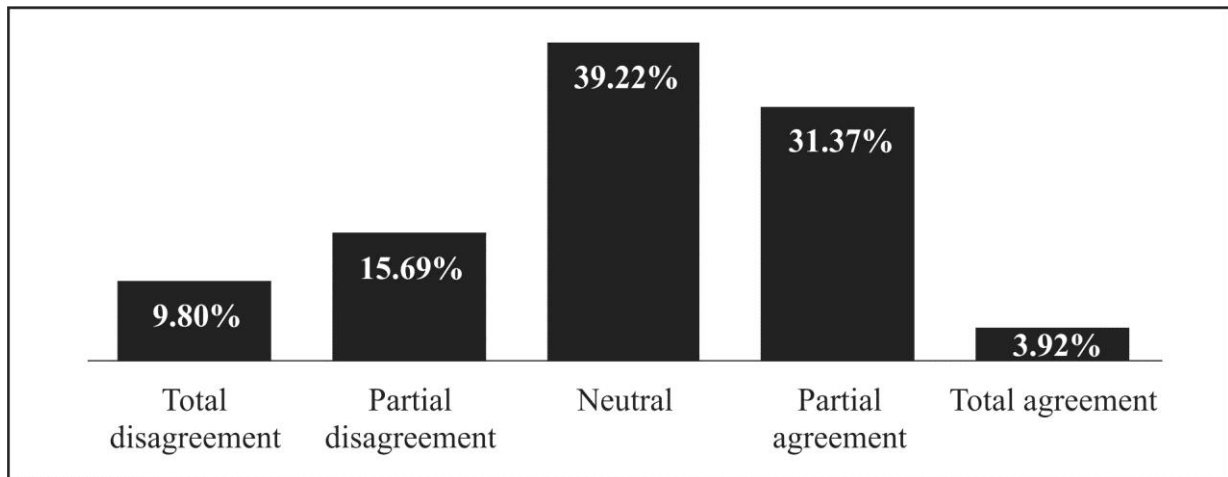


Source: Own processing

In this case, a 45% percentage of the respondents express their disagreement, while only 27.45% of respondents remain neutral.

V. Accounting problems under negotiation (unaudited accounts balances' and analysts' forecasts) affect the negotiation process (Figure no. 6).

Figure no. 6 - Accounting issues under negotiation



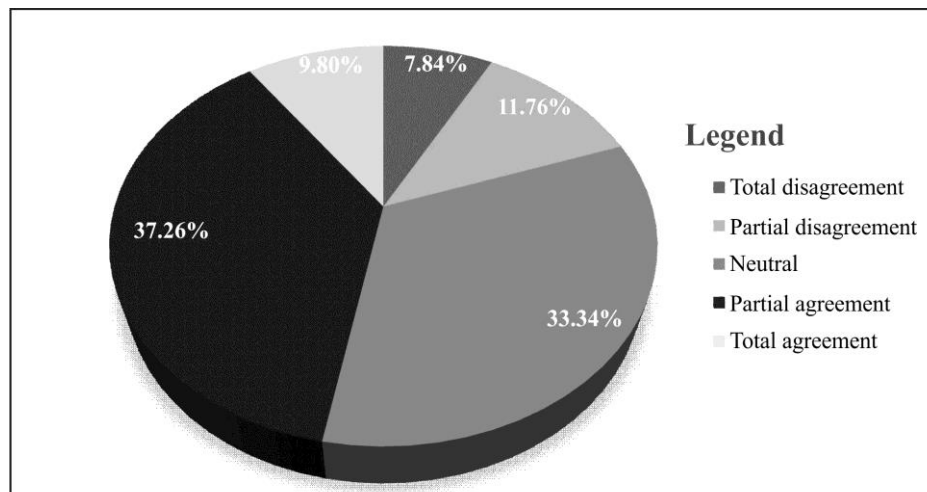
Source: Own processing

Most respondents (39.22%) declare themselves neutral in agreeing to this statement.

Accounting Standards are vague because customers use this situation (the ambiguity of standards) to justify aggressive accounting treatments applied (Figure no. 7).

VI. The auditor is in a position to negotiate with their auditees on controversial accounting items for which

Figure no. 7. Ambiguity of Standards

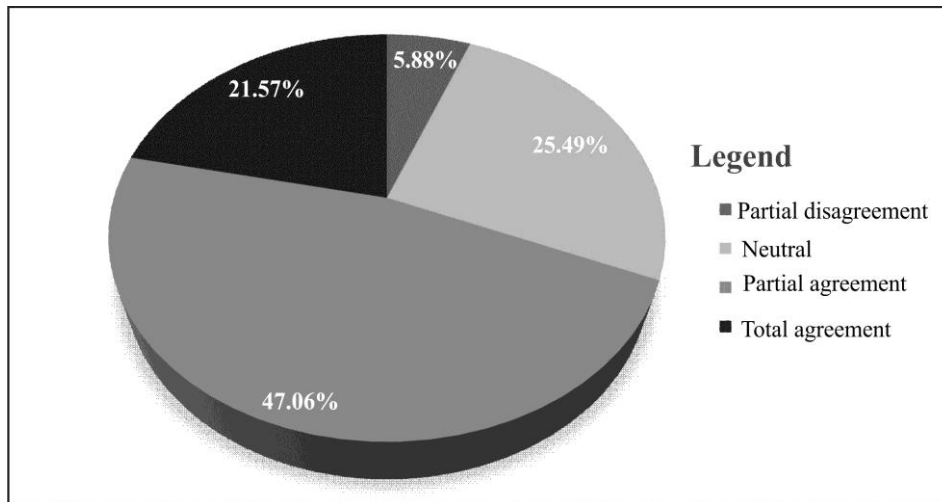


Source: Own processing

47% of the respondents expressed their total or partial agreement with this statement. One third of those surveyed remained neutral.

VII. In negotiating with the auditee in respect of the accounting items, the auditor considers the Accounting Standards rationally and reasonably, rather than interposing them for the application of accounting treatment in preparing the financial statements (Figure no. 8).

Figure no. 8. Negotiation - Accounting Standards

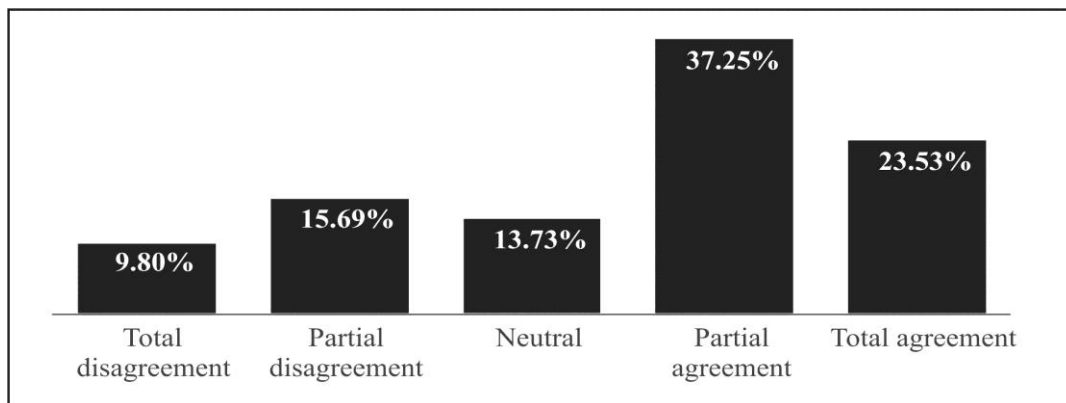


Source: Own processing

Respondents expressed their total or partial agreement on this claim in a proportion of 68% of the sample.

VIII. The lack of negotiating experience of the auditor adversely affects his ability to persuade the auditee to record and recognize the adjustments identified during the audit engagement (Figure no. 9).

Figure no. 9. Lack of auditor experience

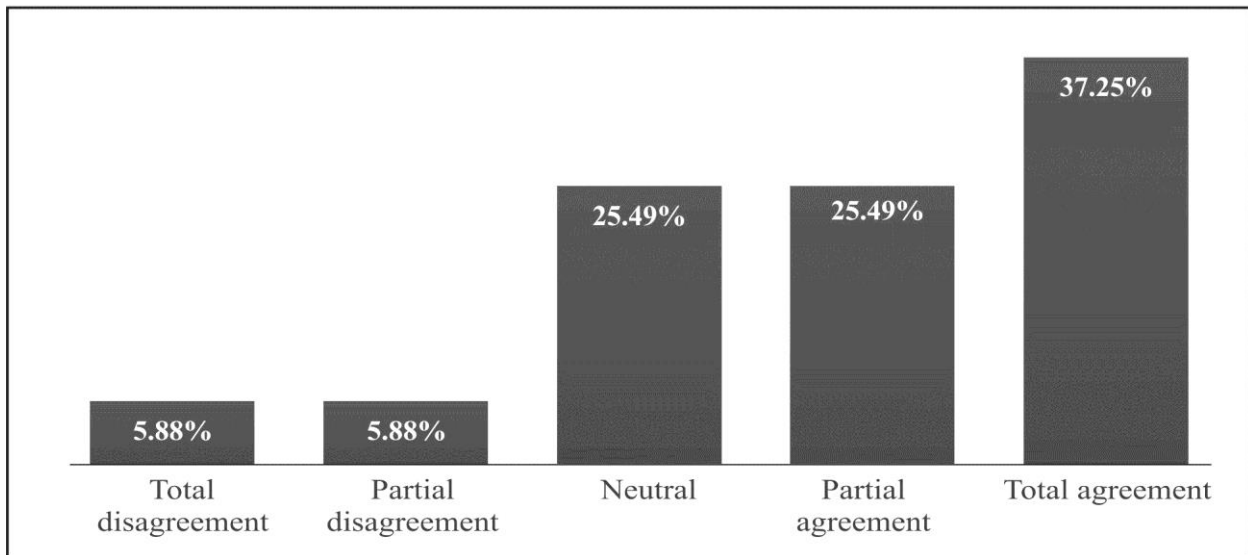


Source: Own processing

Respondents agree with this assertion in a proportion of 60.78% of the analyzed sample. Therefore, the lack of experience in negotiation negatively influences the negotiation process.

IX. The lack of knowledge and experience of the auditor adversely affects the performance and results of the negotiation (Figure no. 10).

Figure no. 10. Lack of knowledge and experience in the field

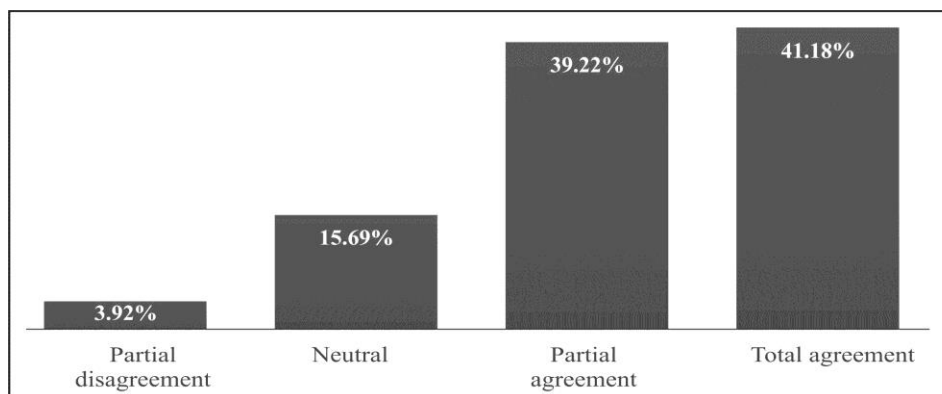


Source: Own processing

Approximately 63% of respondents agree with this statement, while 25.49% remain neutral. The more the auditor has more knowledge in the field and a wealth of experience, the more the results of the negotiations will be more satisfactory.

X. The integrity and power of corporate governance mechanisms are considered essential in the context of auditing-auditee negotiations (Figure no. 11).

Figure no. 11. Integrity and Power of Governance Mechanisms



Source: Own processing

In this assertion, the respondents expressed their agreement in the proportion of 80.4% of the sample.

4.3. Bivariate analysis

The bivariate analysis consists in the simultaneous processing of data relating to two variables and aims at highlighting possible "relationships" that might exist between these variables.

The assumed hypothesis: Familiarity between the auditor and the auditee influences the relationship between the two.

To validate this hypothesis, we analyze the links between the familiarity between the auditor and the auditee.

Analysis of the link between variables:

- familiarity between the auditor and the auditee influences the terms of the audit contract in the interest of both parties.
- familiarity between the auditor and the auditee influences the choice of the type of procedures used by the auditor during the audit engagement.

We formulate the statistical assumptions:

- the null hypothesis H0: "There is no link between the two variables"
- alternative hypothesis H1: "There is a link between variables"

We apply Kendall's correlation test and get the result represented in **Table no. 5**.

Table no. 5. Correlation 1				
			1) Influences the terms of the audit contract in the interest of both parties	2) Influences the choice of the auditor regarding the type of the procedures used on the audit mission
Kendall's tau_b	1) Influences the terms of the audit contract in the interest of both parties	Correlation Coefficient Sig. (2-tailed) N	1.000 - 49	.302* .011 49
	2) Influences the choice by the auditor of the type of procedures used during the audit engagement	Correlation Coefficient Sig. (2-tailed) N	.302* .011 49	1.000 - 49

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Own processing, SPSS Statistics 17.0

- Because the probability of accepting the null hypothesis is below 5% (Sig=0.011), we reject the null hypothesis and accept the alternative hypothesis. Therefore, there is a link between the two variables analyzed.
- On the other hand, because the correlation coefficient of Kendall (K=0,302) is positive, we deduce that the link is direct between the two variables, namely the respondents who agree that the familiarity between the auditor and the auditee influences in the interest of both parties the clauses related to the audit agreement, have the same level of agreement that the familiarity between the auditor and the auditee influences the auditor's choice of the type of procedures used during the audit engagement.

Analysis of the link between the variables:

- familiarity between the auditor and the auditee influences the terms of the audit contract in the interest of both parties.
- familiarity between the auditor and the auditee influences the auditor's professional judgment regarding the materiality threshold calculation.

We formulate the statistical assumptions:

- null hypothesis H0: "There is no relationship between the two variables"
- alternative hypothesis H1: "There is a link between variables"

We apply Kendall's correlation test and get the result represented in **Table no. 6**.

Table no. 6. Correlation 2

			3) Influences the terms of the audit contract in the interest of both parties	4) Influences the auditor's professional judgment regarding the calculation of the materiality threshold
Kendall's tau_b	3) Influences the terms of the audit contract in the interest of both parties	Correlation Coefficient	1.000	.367**
		Sig. (2-tailed)	-	.002
	N	49	49	
	4) Influences the auditor's professional judgment regarding the calculation of the materiality threshold	Correlation Coefficient	.367**	1.000
Sig. (2-tailed)		.002	-	
N	49	49		

** . Correlation is significant at the 0.01 level (2-tailed).

Source: Own processing, SPSS Statistics 17.0

- Because the probability of accepting the null hypothesis is below 5% (Sig=0.02), we reject the null hypothesis and accept the alternative hypothesis. Therefore, there is a link between the two variables analyzed.
- On the other hand, because Kendall's correlation coefficient (K=0,367) is positive, we deduce that the link is direct between the two variables, namely the respondents who agree that the familiarity between the auditor and the auditee influences in the interest of both parts the audit contract terms, have the same level of agreement that familiarity between the auditor and the auditee influences the auditor's professional judgment regarding the materiality threshold calculation.

Analysis of the link between the variables:

- The auditor sometimes approves the auditee's alternative to maintain the auditor-auditee relationship, although this will increase their exposure to public conflicts and litigation.
- Both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options.

We formulate the statistical assumptions:

- null hypothesis H0: "There is no link between the two variables"
- alternative hypothesis H1: "There is a link between variables"

We apply Kendall's correlation test and get the result represented in **Table no. 7.**

Table no. 7. Correlation 3

			5) The auditor sometimes approves the auditee's alternative to maintain the auditor-auditee -client relationship, although this will increase their exposure to public conflicts and litigation	6) Both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options
Kendall's tau_b	5) The auditor sometimes approves the client's alternative to maintain the auditor-auditee relationship, although this will increase their exposure to public conflicts and litigation	Correlation Coefficient	1.000	.373**
		Sig. (2-tailed)	-	.002
	N	51	51	
	6) Both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options	Correlation Coefficient	.373**	1.000
Sig. (2-tailed)		.002	-	
N	51	51		

** . Correlation is significant at the 0.01 level (2-tailed).

Source: Own processing, SPSS Statistics 17.0

- Because the probability of accepting the null hypothesis is below 5% (Sig=0.02), we reject the null hypothesis and accept the alternative hypothesis. Therefore, there is a link between the two variables analyzed.
- On the other hand, because the correlation coefficient of Kendall (K=0,373) is positive, we deduce that the link is direct between the two variables, namely the respondents who agree that the auditor sometimes approves the auditee's alternative to maintain the relationship auditor-auditee, although this will increase their exposure to public conflicts and litigation, have the same level of agreement on the fact that both the auditor and the auditee have a mutual interest in negotiating and can choose from several acceptable reporting options.

5. Conclusions

This study aimed to study the link between the variables on the relationship between the auditor and the auditee in the negotiation process throughout the audit engagement, from accepting the mission and signing the contract to expressing the opinion based on respondents' responses.

Thus, based on the literature and the working tool (questionnaire), it was possible to demonstrate that the auditor-auditee relationship is a key factor in establishing negotiation strategies between these two parties. Researchers share common concepts around negotiations, especially all theories emphasize that actors believe negotiation allows them to achieve better results.

Familiarity between the auditor and the auditee is defined by audit standards as a threat to the audit engagement. According to the answers obtained and the analysis made of this, familiarity affects the clauses of the audit contract in the interest of both parties, but it is also necessary for the auditor to understand the client sufficiently well to plan and perform an effective audit.

Both the auditor and the auditee have a mutual interest in negotiating. They can choose from several acceptable reporting options, but accounting conservatism, namely the prudence principle, applies. The compliance with the accounting rules, transparency and veracity of the

financial statements are a key factor in the start of the audit engagement.

Auditors also disclose the need to record accounting adjustments when appropriate, regardless of management's view to accept or not the proposed adjustment.

In negotiating with the auditee in respect of accounting matters, the auditor takes into account the rational observance and application of the Accounting Standards, rather than their interpretation for the application of the accounting treatments in the preparation of the financial statements. Also, the respondents of the questionnaire strengthen the assertions of the specialized literature.

Also, according to the literature and the present study, the lack of experience in negotiation and the lack of experience and knowledge in the field negatively influence the performance and results of the negotiation, corporate governance being essential in the context of the negotiations.

Bivariate analysis reinforces specialized literature research, which confirms the existence of a relationship between auditor-auditee relationship in the implementation of all negotiation strategies during the audit engagement.

6. Limitations and future research

This research presents some limitations, namely the reluctance of respondents to the subject. Another limitation is that some of the respondents are students who have used their theoretical knowledge to answer my questionnaire without being influenced by the practical experience in the profession of financial auditor.

Gibbins et al. (2005) reported that managers and audit partners have different negotiation results and negotiation strategies. Therefore, it is expected that our participants' responses to be different from those of the audit partners; a future research could duplicate this study of audit partners and compare it to the results of the current study.

As research perspectives, the paper proposes to develop this study on a larger population at national level as well as the introduction of other factors addressing the relationship between the auditor and the auditee in establishing negotiation strategies for choosing the best alternatives.

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