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IMPACT OF RISK EVALUATION ON AUDITOR-AUDITEE NEGOTIATION OUTCOME

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ABSTRACT

This study seeks to investigate the impact of auditee business risk, audit risk, and auditor business risk evaluation on auditor-auditee negotiation outcomes. A model is developed and tested that characterizes the auditor-auditee negotiation outcome as a process of risk evaluation and risk adaptation.

Participants in this study were students of the University of Diponegoro accountant professional education of 60 people who represent partner and manager of Big 4 audit firms. The results show that the partners (participants) considered the relationship between audit risk and auditee business risk. Also, our results indicate that auditee business risk has a significant effect on auditor business risk evaluation and has a significant effect on auditor-auditee negotiation outcomes. So, auditors will be less likely to accept an auditee's aggressive reporting practice when the auditee's business risks are high. On the other hand, results show that audit risk evaluation don't affect auditor-auditee negotiation outcome. Finally, auditor business risk has a nonsignificant effect on auditor-auditee negotiation outcome.

This study provides evidence that despite the expectation of conservatism required by generally accepted auditing principles (GAAP), certain environmental factors may cause auditors to acquiesce to auditee preferences and allow more aggressive reporting. From stakeholders (investors, regulators) perspective, this is not necessarily an optimal criterion for decisions that impact the financial statements. The expectations of stakeholders are that auditors will select the most informative alternative.

The implication for practice is that accounting firms may need to strengthen their internal oversight mechanisms (e.g., peer reviews, concurring partner reviews) to ensure that auditors' decisions are aligned with the firm's, as well as stakeholders' expectations of audit quality. So, auditors must pay more attention to financial statements when business risk is high.

Keywords: Auditor-Auditee Negotiation, Auditee Business Risk, Audit Risk, Auditor Business Risk, Prospect Theory.

1. INTRODUCTION

Audited financial statements are a joint product of both the auditor and the auditee (McCracken, Salterio, & Gibbins, 2008), and auditors sometimes play an active role in managing the auditee's financial reporting choices (Nelson, Elliott, & Tarpley, 2002). In the process of financial reporting, circumstances may arise that lead to divergent preferences between auditees and auditors on accounting and reporting issues. The resolution of such financial reporting issues can be especially difficult when generally accepted accounting principles (GAAP) are ambiguous (Johnstone, Bedard, & Biggs, 2002; Nelson & Kinney, 1997), since both parties may make different judgments depending on their preferences. Despite the importance of auditor-auditee negotiation in financial reporting, limited attention has been given to the need for effective negotiations in situations that entail subjective matters (e.g., accounting estimates, imprecise accounting standards) (Gibbins, McCracken, & Salterio, 2005).

The purpose of this study is to examine how certain environmental factors influence negotiation outcomes. More specifically, we try to study the impact of auditee business risk, audit risk, and auditor business risk on auditor-auditee negotiation outcome in Indonesian context.

Developing a framework for understanding the impact of risks on negotiation outcome is important because auditor independence and ability to resist to auditee pressures are the most fundamental and vital asset possessed by the auditing profession. Auditor-auditee interactions are fundamental to preserving audit quality, as these interactions include negotiations over changes in the financial statements necessary for the auditor to provide an unqualified opinion.

Research demonstrates that environmental conditions (e.g., financial dependence) potentially lead to judgment based decisions that affect the content and credibility of financial statements (Hackenbrack & Nelson, 1996; Holm & Laursen, 2007; Johnstone, Sutton, & Warfield, 2001). For example, judgmental situations can reduce actual or perceived audit quality via independence risk. However, environmental characteristics possibly mitigate independence related environmental conditions (Johnstone, Sutton, & Warfield, 2001).

This examination is important because negotiations materially affect the financial statements as auditors actively participate in their auditees' financial reporting choices (Demski & Frimor, 1999; Nelson & Kinney, 1997; Nelson, Elliott, & Tarpley, 2002; Trotman, Wright, & Wright, 2005). However, relatively little is known about how important contextual features such as risk affect auditor-auditee negotiation. Understanding features that affect the negotiation outcome is important because it provides insight on audit practice interventions that can be employed to improve audit quality and reduce litigation exposure on the contentious issues generally resolved via auditor-auditee negotiation.

An emerging line of research is investigating how auditors and their auditees interact to resolve disputed financial reporting issues, building from the auditor-auditee negotiation model developed in Gibbins, Salterio, and Webb (2001); Sahnoun and Zarai (2009). That model highlights the importance of accounting contextual features that may affect negotiations (e.g., auditee and auditor negotiation capabilities, financial reporting regulation, and risk, among others). Gibbins, Salterio, and Webb (2001) validate their model using survey data of auditors' self reported negotiations, and call for future research that examines negotiation outcomes, and that considers contextual features such as the riskiness of the negotiation context. Sahnoun dan Zarai (2009) validate their model using experiment data (using 200 Tunisian auditors as participants), and suggests for future researach that global evaluation of business risk is needed, specifically in international research is needed to analyze the risk/negotiation outcomes relationship in other countries where different standards, structures, cultures, and legal environmental prevail.

We extend this emerging line of research using an experimental task. We rely on Prospect Theory (Kahneman & Tversky, 1979) and related findings in the negotiation literature (Neale & Bazerman, 1991), which help to link motivations for risk seeking versus risk aversive behavior with negotiation decision making to motivate our expectation that auditors in the high risk context will exhibit superior performance in terms of negotiation outcome.

2. LITERATURE REVIEW

Negotiation is a process by which a joint decision is made by two or more parties. The parties first verbalize contradictory demands and then move toward agreement by a process of concession making or a search for new alternatives. The very nature of the audit function can necessitate negotiation between the auditor and the auditee to resolve disputed financial reporting issues. For example, before an auditor is willing to express an unqualified opinion on an auditee's financial statements, any disputed accounting issues must be resolved. The resolution of these issues may result in a negotiation between the auditor and the auditee, where the auditee is likely to attempt to persuade the auditor to accept his/her position and vice versa.

Negotiations may have a variety of outcomes (e.g., impasse or mutual agreement) (Thompson, 1990). Generally, negotiators reach an agreement with the other party if it is in their best interest to do so (Thompson, 1990). The auditor and the auditee have joint interests; auditors are generally interested in auditee retention, and auditees want to obtain an unqualified audit report (Gibbins, Salterio,&Webb, 2001). Therefore, it is likely that auditor-auditee negotiations will result in mutual agreement. The process of reaching a mutual agreement may involve both parties making concessions so that each party gets at least a part of his or her preferred outcome.

MODEL DEVELOPMENT AND HYPOTHESES

Model in this reseach includes two phases: a risk evaluation phase and a risk adaptation phase. The first phase characterizes how risks are integrated to form an overall evaluation of the riskiness of the auditee. The second characterizes adaptation strategies in auditor-auditee negotiation that auditors may use in response to the evaluated risks.

Risk Evaluation

The first phase of the model includes the evaluation of relevant risks. These risks include the auditee's business risk, audit risk, and the auditor's business risk (Colbert, Luehlfing, & Alderman, 1996; Huss & Jacobs, 1991). Auditee's business risk is the risk that the auditee's economic condition will deteriorate in either the short or long term (e.g., as proxied by profitability and liquidity) (Johnstone, 2000). Auditor's business risk is the risk that the audit firm will suffer a loss resulting from the engagement (e.g., as proxied by engagement profitability and potential litigation).

Research shows that the auditee's financial condition can affect the evaluation of audit risk, and vice versa (Kotchetova, Kozloski, & Messier, 2006; O'Keefe, King, & Gaver, 1994; Wu, Roebuck, & Summers, 2002).While this research led in the context of the auditor-auditee negotiation, professional standards indicate that auditors should evaluate these risks. It seems logical that auditee's business risk and audit risk, both unique to the auditee, might affect each other as the auditor evaluates the auditee related risks. For example, an auditee with weak internal controls that operate in an inherently risky industry may have difficulty obtaining debt financing at reasonable interest rates, thereby affecting the auditor's evaluation of the auditee's financial prospects. Alternatively, an auditee in deteriorating financial condition might reduce its administrative staffing, affecting the strength of its internal control systems and the auditor's evaluation of control risk (Johnstone, 2000).

This discussion suggests the following hypothesis:

***H1a**: Partners' evaluations of auditee's business risk will relate positively to partners' evaluations of audit risk and vice versa.*

Additional research provides evidence about how the auditee related risks might affect auditors' evaluations of the risk that the audit firm will suffer a loss on the engagement (auditor's business risk). Prior research focusing on litigation against audit firms demonstrates that as the auditee's financial condition declines, the likelihood that the auditor will suffer a loss related to the engagement increases (Pratt & Stice, 1994; Schipper, 1991). Increases in audit risk factors also increase the likelihood that the auditor will suffer a loss (Kruetzfeldt & Wallace, 1986). Since auditors' evaluations of auditee's business risk and audit risk could be related (i.e., *Hla*), the relative influence of auditee's business risk on auditor's business risk and the relative influence of audit risk on auditor's business risk reported in prior studies might differ when the impact of auditee's business risk and audit risk are measured simultaneously, as is done in this study.

Asare, Hackenbrack, and Knechel (1994) report that they do consider how an auditee's business risk and audit risk affect their own firm's risk of loss. Given the litigious and highly price competitive environment in which accounting firms operate, these links seem logical. For example, an auditee with a higher level of audit risk is more likely to require costly auditing procedures and is more likely to be associated with an audit failure which results in negative publicity and costly legal judgments against the accounting firm. Similarly, auditee financial distress can lead to immediate declines in auditor profitability via reduced or unpaid audit fees, and can also result in costly legal judgments against the accounting firm (Fukukawa, Mock, & Wright, 2006).

This discussion suggests the following hypotheses:

H1b*: Partners' evaluations of audit risk will relate positively to partners' evaluations of auditor's business risk.*
H1c*: Partners' evaluations of auditee's business risk will relate positively to partners' evaluations of auditor's business risk.*

Adaptation Phase

The second phase of the auditor-auditee negotiation outcome model is an adaptation phase. Drawing from accounting contextual features identified by Gibbins, Salterio, and Webb (2001); Sahnoun and Zarai (2009) as important in auditor-auditee negotiations, we examine how risks evaluations influence auditor decision during auditor-auditee negotiations. Research demonstrates that risk influences decision making behavior (e.g., Gibbins, McCracken, & Salterio, 2008; Hackenbrack & Nelson, 1996; Johnstone, Bedard, & Biggs, 2002) and is an important aspect of the overall audit environment (Bell et al., 2002).

Prospect Theory suggests that people are risk averse in situations where they are confronting potential gains and that they are risk seeking in situations where they are confronting potential losses (Kahneman & Tversky, 1979). The negotiation literature shows that the risk adverse course of action is to accept an offered settlement, hereas the risk seeking course of action is to hold out for future, potential concessions (Neale & Bazerman, 1991). This implies that people in riskier situations will adopt a more contending strategy as they hold out for superior negotiated outcomes. This expectation is confirmed in an experiment by Neale and Bazerman (1991) who show that individuals in a negatively framed condition (a situation described as involving serious financial losses) are more contending and achieve superior negotiated outcomes compared to individuals in a more positively framed financial condition.

Building on the findings regarding the role of risk in financial reporting choice (prospect theory), we expect that in riskier situations, auditors will work to achieve a more conservative financial reporting outcome, and since that alternative is more conservative, they will be more confident that the final negotiated outcome is acceptable under GAAP.

Auditee Business Risk and Auditor-Auditee Negotiation.

Huss and Jacobs (1991) reported that auditee business risks may affect auditors' decisions on whether to accept or to continue audit engagements, since an auditee's business risks, in turn, affect auditor business risks due to the potential loss of audit fees and litigation, should the company become insolvent. For example, in making auditee acceptance decisions, auditors assess that high auditee business risks could result in high auditor business risks (Johnstone, 2000).

Prior research has also reported that the likelihood of auditor litigation is greatly increased for failing firms, as investors, creditors, and others seek to recoup financial damages. Asare, Haynes, and Jenkins (2007) studied the impact of auditee business risk and auditor business risk on auditor decision. Their results show that the auditor pays more effort to examine financial statements when auditee business risk is high. In the same way, Chang and Hwang (2003) report that auditee business risk has a significant effect on auditor decision to accept auditee's practices. Braun (2001) shows that the auditors are incited to accept auditee's aggressive practice when auditee financial position is good.

Hence, we predict that the likelihood that auditors will accept an auditee's aggressive reporting practices may decrease as the level of the auditee's business risks increase.

***H2a**: Partners' evaluations of auditee business risk will relate negatively to auditor-auditee negotiation outcome.*

Audit Risk and Auditor-Auditee Negotiation

Audit risk is defined as the auditor giving "an inappropriate audit opinion on financial statements" (Mulyadi, 2007). This risk has three key components: inherent risk, control risk, and detection risk (Mulyadi, 2007). Inherent and control risk are risks which lie within the company itself. Detection risk lies with the auditors. The extent of substantive testing carried out by an auditor is a function of the assessment of the level of inherent and control risk within the company.

Several studies examined the effect of audit risk or more precisely detection risk on auditor decision. Sankaraguruswamy, Raghunandan, and Whisenant (2005) studied the factors associated with auditor-auditee negotiation outcome; they found that audit risk affected auditor-auditee negotiation outcome.

If inherent risk and control risk are weak, the auditor could, owing to the fact that the detection risk is weak, reduce his accounts controls (substantive tests); it could in this case accept an auditee's aggressive reporting practice. On the other hand, if inherent risk and control risk are medium or high, the auditor should carry out an important work in the form of substantive tests. In this case, the auditor must be careful and conservative in the examination of the methods practiced by the auditee (Houston, 1999).

H2b*: Partners' evaluations of audit risk will relate positively to auditor-auditee negotiation outcome.*

Auditor Business Risk and Auditor-Auditee Negotiation

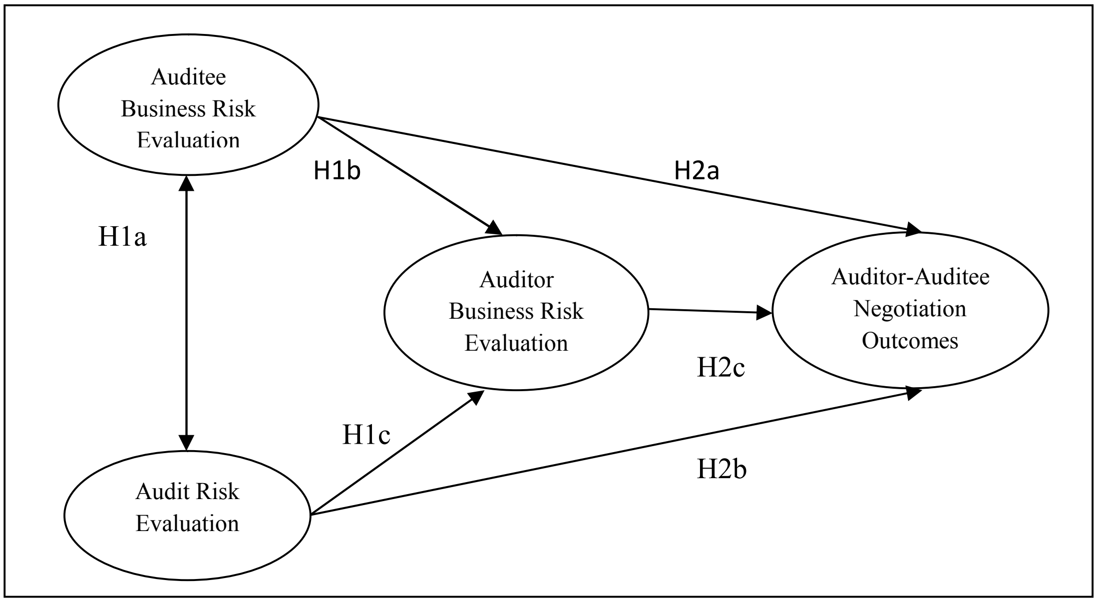
Engagement risk may exist even if there are no misstatements in the financial statements and the audit is conducted according to professional standards (Rittenberg & Schwieger, 2001); it is an important part of the audit environment (Bell et al., 2002).

Research examining the influence of engagement risk on auditor decision making (Johnstone, 2000) provides evidence to support the importance of engagement risk in the audit setting. Engagement risk is likely to affect negotiated outcomes because research demonstrates that engagement risk influences auditors' judgment based decisions (Hackenbrack & Nelson, 1996; Johnstone, Bedard, & Biggs, 2002). Johnstone, Bedard, and Biggs (2002) examine auditors' generation of financial reporting alternatives in a setting in which an audit auditee proposes an aggressive financial reporting alternative for a complex revenue recognition issue. They find that higher engagement risk is associated with the generation of a greater number and range of financial reporting alternatives, particularly for high knowledge auditors.

Hackenbrack and Nelson (1996) find those auditors' incentives to make aggressive reporting decisions vary as a function of engagement risk. If engagement risk is moderate, auditors prefer an aggressive reporting method. Conversely, if engagement risk is high, auditors prefer a conservative reporting method.

H2c*: Partners' evaluations of auditor business risk will relate negatively to auditor-auditee negotiation outcome.*

Figure 1
Auditor-Auditee Negotiation Model



3. RESEARCH METHODS

Participants

Participants in this study were students of the University of Diponegoro accountant professional education of 60 people who represent partner and manager of Big 4 audit firms.

Experimental Design and Procedures

The experiment is a 2 x 2 x 2 factorial design, yielding eight case versions that range from relatively low to relatively high levels of risk. Each participant was assured of confidentiality and was requested to complete a questionnaire in a timely manner.

The research instruments were developed based on the Johnstone (2000) study and Sahnoun and Zarai (2009). Each participant chose at random two case studies and completed them. The cases were constructed with the assistance of two partners' auditors, one of which is from Big 4 audit firm. Each case began with a description of the company, including information about growth prospects, reasons for switching auditors, and fiscal year end information. A description of the company's management followed, including information about their relationship with the prior auditor. The level of industry competition was also described.

Financial information included a summary of sales, net income, and financial ratios, including industry comparison information. Following the financial information was about the company's internal control structure, the degree of judgment required to value significant company assets, the audit firm's expertise, and expected competition from other audit firms. After reading each case study, partners (participants) evaluated risks and then made decisions. Finally, participants completed a debriefing questionnaire.

Independent Variables

The independent variables include auditee's business risk (high, low), audit risk (high, low), and auditor's business risk (high, low). Information used to manipulate auditee's business risk and audit risk was developed based on prior studies and professional standards. The auditee's business risk manipulation included information about financial ratios and trends (Johnstone, 2000; Pratt & Stice, 1994), management's long term planning activities (Ponemon & Schick, 1991), and industry competition (Huss & Jacobs, 1991). The audit risk manipulation included information about the auditee's industry (Maletta & Kida, 1993), the past auditee auditor relationship (Johnstone, 2000), the degree of judgment required to value significant accounts (Pratt & Stice, 1994), management's attitude toward internal controls and the internal audit department (Maletta & Kida, 1993).

Dependent Variables

After participants received the above manipulations within the case, the participants' evaluations of the three risks were measured, yielding the following latent constructs: auditee's business risk evaluation; audit risk evaluation; and auditor's business risk evaluation.

Indicators of the auditee's business risk evaluation and the audit risk evaluation constructs have been developed based on prior studies that have operationalized these constructs (Pratt & Stice, 1994). Indicators of the auditee's business risk evaluation include participants' assessments of the company's short term liquidity, short term profitability, and long term financial viability. Indicators of the audit risk evaluation include participants' assessments of the likelihood of material misstatement, the company's inherent risk, and the company's control risk.

Auditor-auditee negotiation outcome is being measured by one indicator. A scale of 7 points will be used to specify negotiation outcomes.

Statistical Method

This reseach to test the model (Figure 1) used the maximum likelihood procedure in AMOS 16 (Ghozali, 2008).

4. RESULTS AND DISCUSSION

Measurement Model and Descriptive Statistics

The results of evaluating the measurement model are described below (Table 1). Table 1 shows that the means of the three indicators of auditee business risk are close to each other 3.89, 4.43, 4.21 proving the bond between different items relative to auditee business risk. For other variables, which have averages of 3.93, 3.97, 4.23 for audit risk and 4.07 and 3.98 for auditor business risk. For negotiation variable, the mean is about 4.07, so more medium degree of agreement exists between auditors and auditees.

As far as the standard deviation, we note a slight variation of variables in our sample. Indeed, the more the degree of fluctuation measured by the standard deviation is weak, the more the estimate quality is good.

Examination of the correlation matrix reveals that partners viewed the auditee's business risk evaluation, the audit risk evaluation, and the auditor's business risk evaluation as distinct constructs. For example, the indicators of the auditee's business risk evaluation, Abrl (short term liquidity), Abr2 (short term profitability), and Abr3 (long term financial viability), are highly correlated to each other (correlations of 0.69, 0.73, and 0.72, respectively) and are less highly correlated to the audit risk evaluation or auditor's business risk evaluation indicators.

Similarly, the indicators of the audit risk evaluation, Arl (material misstatement), Ar2 (inherent risk), and Ar3 (control risk), are highly correlated to each other (correlations of 0.86, 0.81, and 0.76, respectively) and are less highly correlated to the auditee's business risk evaluation or auditor's business risk evaluation indicators. The indicators of auditor-auditee negotiation outcomes are highly correlated to auditee business risk.

The indicators of the auditee's business risk, audit risk evaluations and auditor Business risk have standardized factor loadings that are well above the .60 benchmark (see Table 1). So, no modifications are required to achieve a good fitting measurement model for these constructs.

TABLE 1
Correlation Matrix and Descriptive Statistics

	Abr1	Abr2	Abr3	Ar1	Ar2	Ar3	Aobr1	Aobr2	N	Means	Standars Deviation	Loading
Abr1									60	3.89	1.54	0.80
Abr2	.69								60	4.43	1.59	0.81
Abr3	.73	.72							60	4.21	1.70	0.83
Ar1	.07	.04	.03						60	3.93	1.69	0.83
Ar2	.08	.01	.06	.86					60	3.97	1.72	0.80
Ar3	.03	.06	-.02	.81	.76				60	4.23	1.58	0.81
Aobr1	-.02	-.02	.12	.63	.59	.45			60	4.07	1.65	0.81
Aobr2	.18	.23	.34	-.09	-.04	-.04	.10		60	3.98	1.79	0.83
Aano	.24	.27	.15	.19	.08	.06	.04	.07	60	4.07	1.56	0.84

Sumber: Data Diolah, 2011

Abr: Auditee business risk
Ar: Audit risk
Aobr: Auditor business risk
Aano: Auditor-auditee negotiation outcomes

Structural Model

Results of testing the structural model provide evidence about whether the auditor-auditee negotiation outcomes model in Figure 1 is consistent with the experimental data. The overall model goodness of fit measures (probability ≥ 0.05, RMSEA ≤ 0.08, dan GFI, AGFI, TLI ≥ 0.90).

TABLE 2
Statistic Results of the SEM Analysis

	t	p
H1a: Auditee business risk/ Audit risk	0.28	0.00
H1b: Auditee business risk/ Auditor business risk	0.69	0.00
H1c: Audit risk/ Auditor business risk	0.54	0.00
H2a: Auditee business risk/ Auditor-auditee negotiation outcomes	- 0.39	0.00
H2b: Audit risk/ Auditor -auditee negotiation outcomes	-0.11	0.63
H2c: Auditor business risk/ Auditor-auditee negotiation outcomes	0.03	0.97

Sumber: Data Diolah, 2011

Hypothesis 1 tests the risk evaluation phase of the model (see Table 2). Hypothesis 1a proposes that partner's evaluations of auditee's business risk and audit risk will affect each other. The path from the audit risk evaluation to the auditee's business risk evaluation is significant ($t = + 0.28$, $p < 0.05$), providing partial support for the hypothesis. The reciprocal path, from the auditee's business risk evaluation to the audit risk evaluation, is also significant, so hypothesis 1a is supported. Hypotheses lb and 1c propose that partner's evaluations of auditee's business risk and audit risk will affect partners' evaluations of auditor's business risk. The paths from the auditee's business risk evaluation to the auditor's business risk evaluation are significant ($t = +0.69$, $p < 0.05$), so supports H1b. The significance of the paths from the audit risk evaluation to the auditor's business risk evaluation ($t = +0.54$, $p < 0.05$) supports H1c.

Hypotheses 2 test the adaptation phase of the model. Hypothesis 2 tests whether partners' evaluations of risks directly affect the auditor-auditee negotiation outcomes. Hypothesis 2a predicts that the auditee's business risk evaluation (i.e., partners' assessments of the auditee's profitability, liquidity, and financial viability) will relate negatively to the decision. Hypothesis 2a is supported, since the path from the auditee's business risk evaluation to auditor-auditee negotiation outcomes ($t = -0.39$, $p < 0.05$) is significant.

H2b predicts that the audit risk evaluation (i.e., partners' assessments of the auditee's inherent and control risk) will relate negatively to the negotiation. The path from the audit risk evaluation to auditor-auditee negotiation (H2b) is not significant.

Hypothesis 2c tests whether auditors' evaluations of their own firm's risk of loss (auditor's business risk) affect the auditor-auditee negotiation. The result shows that the auditor's business risk evaluations are not related to auditor-auditee negotiations.

5. CONCLUSION, LIMITATIONS, AND IMPLICATION

This study develops and experimentally tests a risk-based model of the outcome of auditor-auditee negotiation. Auditee's business risk, audit risk, and auditor's business risk are manipulated and the relationships between partners' evaluations of these risks and the auditee auditor negotiation outcome are measured. The findings show that partners evaluated the auditee's risks substantially as expected and adapt to those risks in negotiating with auditees.

The results relating to the risk evaluation phase of the model show that partners' evaluations of audit risk affect their evaluations of the auditee's business risk and that both of these auditee-related risk evaluations do affect partners' evaluations of auditor's business risk.

Finding related to the risk adaptation phase of the model concerns the relative influence of the auditee's business risk on auditor-auditee negotiation outcomes. This result confirms the expectation of prospect theory, so auditors in riskier situations will adopt a more contending negotiation strategy, and accordingly will go through more rounds of negotiation with the auditee, and will switch their bargaining position less often as they demonstrate reluctance to acquiesce to the auditee. In riskier situations, auditors will work to achieve a more conservative financial reporting outcome. So, when auditee business risk is high, Indonesian auditors (specifically for auditors at Center Java) became more conservative in order to preserve their reputation and reduce litigation risk. The company went bankrupt without any attempt at prevention on the part of the auditor. The government and small shareholders who criticized the external auditors did not adequately support claims audited, and certifying a false balance sheet, turned against him, and the courts have sentenced him to imprisonment. The Indonesian audit market is very competitive and an auditor seeks to preserve his reputation, his auditees, and consequently his financial conditions. Indonesian case makes a partial support for prospect theory.

The conclusions based on the findings of this study are limited by the study's design. First, participants in this study is students of the University of Diponegoro accountant professional education of 60 people, with the result that unfavourable. Second, generalization of the results regarding the evaluated risks is limited to the indicator variables measured in the study. Future research would benefit by using the indicator variables found to be significant in the measurement model and by experimenting with indicator variables not included in this study, for example the individual effect of each risk on negotiation outcome.

This study makes several significant contributions. First, it respond to calls for negotiation research that investigates the role of risk, which is particularly relevant today as auditors operate in a highly litigious political environment where negotiation between auditees and their auditors is viewed as a potentially problematic aspect of the dual role of both parties in the financial reporting process Second, understanding how auditors respond to risky versus less risky auditees during auditor-auditee negotiation is important and has important audit quality and public policy implications. Third, despite the expectation of conservatism required by GAAP, the findings suggest that certain environmental factors may cause auditors to acquiesce to auditee preferences and allow more aggressive reporting. From a stakeholders (e.g., investors, regulators, state) perspective this is not necessarily an optimal criterion for decisions that impact the financial statements.

The results of this study should provide implications for regulatory policy makers. Auditor independence is a crucial factor for auditor accountability that not only affects the results of auditor-auditee negotiations, but also affects the audit report users such as investors, creditors, and other related parties who rely on the audited financial statements. Also, our results support the need for the recent regulations in Indonesian that seek to increase the demand for independent audits; additional measures are necessary to curb opinion shopping, including the need to further develop regulations that require detailed public disclosure of auditor-auditee disagreements. Understanding features that affect the negotiation outcome provides insight on audit practice interventions that can be employed to improve audit quality and reduce litigation exposure on the contentious issues generally resolved via auditor-auditee negotiation.

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