THE EFFECT OF AUDIT TEAM NORMS ON AUDITOR OBJECTIVITY

Mojtaba Adili, Shahid Bahonar University of Kerman, Kerman, Iran
Ahmad Khodamipour, Shahid Bahonar University of Kerman, Kerman, Iran
Omid Pourheidari, Shahid Bahonar University of Kerman, Kerman, Iran

ABSTRACT

Legislators have enacted laws and standards to develop the ethical conduct among auditors. However, unethical behaviours among auditors still take place. Audit standards require auditors to understand objectivity risks and do something to avoid contact with these risks. The suggested reason behind constrained auditor objectivity has been devoted to auditors' financial incentives and long audit tenure. Regulators propose auditor rotation against constrained auditor judgment induced by the auditor-client relationship. Recent research has challenged those assumptions and questioned the potency of auditor rotation to counteract short-tenure risks to auditor objectivity. This study examines whether audit team norms improve the objectivity of auditor judgment. A cross-sectional design was used and responses from Iranian auditors were analyzed statistically. The findings indicate that audit team norms are associated with improved auditor objectivity.

Keywords: Auditor Objectivity, Objectivity Risks, Audit Team Norms, Auditor Rotation.

INTRODUCTION

While there are numerous evidence that a long-term tenure of auditors may reduce the auditor's independence and audit quality (Bamber & Iyer, 2007; Svanberg & Ohman, 2015), other evidence suggest that a long-term tenure of auditors can improve auditors' knowledge and enhance audit quality (Gul, Fung, & Jaggi, 2009). Regardless of which viewpoint is correct, in accounting literature, the auditor constrained objectivity is treated as an issue that relates to the auditor's financial dependence on the client and the close relationship between the auditor and the client (Brooks, Cheng, Johnston, & Reichelt, 2015). In this context, the auditor's rotation is often suggested as a countermeasure to increase the auditor's objectivity (e.g. Haynes, Jenkins, & Nutt, 1998; Kadous, Kennedy, & Peecher, 2003; Carey & Simnett, 2006; Dhaliwal, Gleason, Heitzman, & Melendrez, 2008; Hollingsworth & Li, 2012).

According to Institute of Internal Auditors (IIA), the international association of auditors and the author of the important auditing standards, objectivity as 'a balanced assessment of all the relevant circumstances not unduly influenced by auditors own interest or by others in forming judgments.' In other words, the auditors' objectivity means that the auditor makes his judgment only on the basis of facts and has an unbiased view of the existing circumstances. In other words, the auditor will do his/her work and not be influenced by others. Obviously, when the auditor looks at how his findings and opinions will affect others, his objectivity will be undermined.

The necessity for auditor objectivity arises from the fact that many of the important issues involved in the preparation of financial statements are related to questions of judgment rather than questions of fact. For instance, the board of directors has various choices in deciding on the accounting policies to be adopted by the entity. The directors have to select policies that they consider most appropriate and their decision can have a material impact on the financial statements. Furthermore, many items in financial statements cannot be measured with absolute precision and certainty. The directors have to estimate these items and choose one value from a range of possible outcomes. If the directors, whether intentionally or unintentionally, make an inappropriate decision or a biased judgment, the financial statements can be misstated or misleading. (APB Ethical Standard 1, 2011).

The auditors are required to review the followed process and the options selected by managers to prepare financial statements. In fact, auditors should comment on whether the financial statements present a favorable picture of the financial situation and the consequences of the company's operations. The auditor's objectivity requires that the opinion of the auditor be expressed in the light of all available evidence and professional judgment. Also, objectivity requires the use of a robust auditor's approach to opposing, if necessary, mismanagement by managers.

According to recent evidence in the accounting literature, auditor objectivity may be constrained even if the relationship with the client is short in duration. Therefore, auditor rotation is not an absolute solution to improve auditor objectivity (Bauer, 2015). So, research needs to consider other mechanisms to counter objectivity risks.

In this study, we are interested in mechanisms that improve auditor objectivity regardless of whether risks develop over a long tenure or short tenure. Bauer (2015) proposed a mechanism to manage short-tenure risks to objectivity which is to trigger the auditors' professional identities. This method may be difficult to be under management control because auditors are exposed to cues not controlled by the audit firm (Svanberg & Ohman, 2016). Versus, the audit team norms can be controlled by management, and we suggest that strong team norms may be associated with improved auditor objectivity.

Various evidence indicates that team norms have a significant impact on team performance (Feldman, 1984; Yeatts & Hyten, 1998). Cohen (1994) defined Norms as standards that are shared by team members which regulate team behaviour. Barker (1993) states that the emergence of normative rules is one of the building blocks of Self-Managing Teams. The central issue here is the role of consensus building in establishing team norms on service-related issues. Hackman (1987) notes that occurrence of a normative structure is a determining condition to efficiently carry out performance strategies. Therefore, it is desirable that to exist high agreement among team members within the team about the behavioural norms. According to Argote (1989), agreeing about how to solve work problems may be more important than the particular problem-solving method selected. Furthermore, shared visions and values should be powerful, to bind team members together in the collaborative pursuit of customer service goals (Hackman, 1987). When there is a strong agreement between the members of a team about the proper conduct, everyone within the team is forced to participate in order to properly and successfully complete the tasks.

We adopt a cross-sectional research design to examine the association between audit team norms and auditor objectivity, measuring the impact of audit team norms on auditor objectivity. For this purpose, we use the scenario designed by Swanberg & Ohman (2016). According to the scenario, the auditor thinks that an accounting issue is important however the client disagrees. The auditor is asked to consider this scenario regarding his largest client. The extent to which the auditor may resist and do not submit to the client's opinion indicates his objectivity. We use a team norms instrument (4 items) developed Hackman (1987). This instrument especially reflects the occurrence of strong norms with regard to consensus among team members on how to solve work problems, rather than the content of norms.

This study is important to auditors, regulators, and accounting research because to the best of our knowledge, present study is the first to examine whether a strong audit team norms improves auditor objectivity. Especially, it extends the accounting literature that has previously examined financial incentives. For instance, Hollingsworth & Li (2012) investigate the client importance and auditor independence debate. They measured Client importance as the proportion of client non-audit service fees, audit fees, or total fees to the total audit office revenue.

The remainder of the paper is structured as follows: The next section presents a literature review and then presents the study's hypotheses. The third section outlines the research method and the fourth section presents the results. The final section discusses the study's limitations and conclusions and implications for regulation of the profession and for future research.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Based on motivated reasoning theory, in response to efficiency concerns, auditor judge in favor of client preferred alternatives (Bierstaker, Bedard, & Biggs, 1999; Glover, Prawitt, Wilks, & McDaniel, 2005; Haynes et al., 1998). Cianci & Bierstaker (2009) state auditors assess internal control effectiveness higher, and positive information about controls as more relevant, under high (compared to) low time budget pressure. In fact, when time budget pressure is high, auditors overestimate the quality of clients' internal control and justify reduced audit quality acts to themselves. Svanberg & Ohman (2015) argue that auditors who have overly close relationships with their clients tend to acquiesce to the client-preferred accounting status due to the same mechanism, which leads to overestimation of the quality of the client's internal controls. They believe that the same mechanisms reduce audit quality and auditor's objectivity in a close relationship between the auditor and the client. We propose that audit team norms may be an effective solution for bias stemming from the overestimation of internal control quality that happens when time budget pressure is high or when auditors have close relationships with clients. Indeed, audit team norms may be an effective solution in both cases.

Generally, group decisions are superior to individual decisions. However, not all groups are effective, because they are made up of different individuals who interact and undergo groupthink in order to make decisions. Previous studies suggest that social influences (such as subjective norms) predict behavioural intentions (e.g. Buchan, 2005; Park & Blenkinsopp, 2009). According to Institutional theory; an organization is shaped by wider cultural, social and symbolic elements that comprise its environment. To gain legitimacy, organizations implement mechanisms and structures to signal to all what is the expected and acceptable behavior. Organizations operate within a framework of norms, values, and acceptable economic behavior and conformity to socially acceptable norms contribute positively to the organization's survival (Alleyne; Hudaib, & Pike, 2013).

The extent to which a person may exhibit a particular behavior to a large extent depends on the norms of a group which the person is a member. In terms of ethical decision making, norms have attracted much attention where the perceived social pressure found to influence ethical intentions (Ajzen, 1991). Chatman & Flynn (2001) defined team norms as "legitimate, socially shared standards against which the appropriateness of behavior can be evaluated". Norms regulate team behavior by providing 'implicit guidelines' for members. According to De Jong, de Ruyter, & Lemmink (2005), team norms are strong when there is a consensus about the best behaviour among team members. Norms set out what may be done in situations based on the interactions of group members. Bettenhausen & Murnighan (1991) argue that norms may be considered as regular behavioral patterns that are stable and expected by other group members. Narayanan, Ronson & Pillutla (2006) believe that cohesion affects positively the individual's conformity to group norms. Individuals in a group will have a greater willingness to behave ethically when the norms of the group support moral behaviour. Thus, they conclude that group norms moderate the effect of cohesion on unethical behaviour (Kunda, 1999).

We argue that norms in an audit team can have a positive effect on an individual member's behaviour regarding appropriate organizational practice. Hooks et al. (1994) note that social influences such as team norms may colour one's perception of the seriousness of the wrongdoing. Accordingly, we state the following hypothesis:

H1: Audit team norms affect auditor objectivity

METHOD

Sample and Data Collection

The statistical population of this research is all the managers of the audit organization and private audit institutions of the member of the Iranian Association of Certified Public Accountants (IACPA). The selection of this group of auditors for this research is due to two reasons: First, this group is one of the pillars of the audit hierarchy. Secondly, since they have at least three years of audit experience, they have established attitudes and behaviours. The respondents were informed that participation in the study was voluntary, that the obtained information would be used for scientific purposes only. 347 questionnaires were distributed among members of the community, taking into account questionnaires that could not be returned. After the successive attempts, 121 questionnaires were finally collected.

Instrument and Measure

The instrument for team norms was based on the work of Hackman (1987). Following Hackman's notion of norms, our operationalization especially reflects the occurrence of strong norms with regard to consensus among team members on how to solve work problems, rather than the content of norms. In this part of the questionnaire, using a six-point Likert-type scale, asked respondents to respond to items.

Moreover, the questionnaire contained a short case, adapted from research into auditor behaviour in audit conflict situations (Bamber & Iyer, 2007; Knapp, 1985). Respondents were asked to respond based on limited information and consider this case regarding their largest client. The case describes a situation that there is a discrepancy between the auditor and the client about the significance of a certain unrecorded debt discovered by the auditor during the audit. Respondents were asked about the likelihood that they would accept the client's view of the non-significance of these debts and the lack of adjustment of financial statements. They were asked to indicate their response as a likelihood of 1 (very low likelihood) to 10 (very high likelihood). Responses to this case are a measure of auditor objectivity. A lower score represents a lower likelihood that the auditor would acquiesce to the management demand and maintain objective judgment (Svanberg & Ohman, 2016).

All of this measures were adapted from scales validated in previous research (Hackman, 1987; Svanberg & Ohman, 2016).

RESULTS

Descriptive Statistics

In Table 1 demographic information about the respondents is summarized. Based on results, most respondents were men, most worked for private audit institutions. On average, the respondents were 46 years old and had been auditors for just over 22 years. The average audit team norms are 3.57 above the scale midpoint. The auditor objectivity score refers to the likelihood that auditors would dis-agree a client-preferred treatment and require that material liabilities be recorded in the financial statements. A low score indicates a high probability of negative comments regarding the client-preferred treatment, which means a low degree of leniency towards client management. The average score of 1.79 indicates that the sampled auditors wouldn't choose to communicate the problem.

Table 1
DESCRIPTIVE STATISTICS

Variables	Frequency (%)	Mean	SD	Median	Min	Max
Male	91					
Female	9					
audit organization	26.45					
private audit institutions	73.55					
Age (years)		45.97	8.90	45	29	66
Auditor experience (years)		22.05	8.96	21	7	48
Auditor Objectivity (1-10)		1.79	5.2	2	1	10
audit team norms (1-6)		3.57	1.15	3	1	6

Variables: Auditors classified as male or female, and either audit organization or private audit institutions auditors. 'Age' is the auditor's age in years. 'Auditor experience' is the length of time the auditor has worked as an auditor (in years).

Hypothesis Test Results

Table 2 presents Pearson product moment correlation coefficients (Pearson's correlation, for short) for the variables. This coefficient is a measure of the strength and direction of association that exists between several of the variables. The correlations between audit team norms and auditor objectivity is significant ($p<0.05$), indicating preliminary support for H1. Experience and Age are highly correlated and conveying similar information. Thus, only auditor experience is presented in Tables 3 and 4. The exclusion of age from the multiple regression models also prevents multi-collinearity.

Table 2
PEARSON PRODUCT–MOMENT CORRELATIONS

Variables	Audit team norms	Audit team norms
Auditor objectivity	-0.413*	-0.131
Audit team norms		0.286*
$^{*}p<.05$		

Table 3 presents data from a multiple regression of auditor objectivity, and the analysis provides support for H. The coefficient for audit team norms is significant ($p<0.01$) and the size of the coefficient, -0.386, suggests that audit team norms has a substantial impact on auditor objectivity. The values of the variance inflation factor (VIF) were between 1.0 and 1.7, suggesting no multi-collinearity.

The regression clearly indicates the negative impact of audit team norms on the likelihood that the auditor will acquiesce to the client's preferred treatment. This indicates that audit team norms encourage auditor objectivity. It seems to discourage auditors should 'do as they are told'.

Table 3
MULTIPLE REGRESSION OF AUDITOR OBJECTIVITY

Dependent Variables	Predicted sign	Coeff.	sig.	VIF
Audit team norms	-	-0.386	0.002	1.115
Auditor experience	-	-0.126	0.059	1.653
R^2		0.315		
Adj. R^2		0.296		
F		9.526		
Sig.		0.000		

Note: Significance values refer to two-tailed tests. Variables: 'Audit team norms' are standards that are shared by team members which regulate team behaviour. 'Auditor objectivity' is the extent to which an auditor acquiesces to the client-preferred treatment. The number of observations is 121. VIF is the measure of collinearity.

DISCUSSION AND CONCLUSIONS

We extend previous literature by evaluating the extent to audit team norms might protect against deteriorating auditor objectivity. Objectivity is a matter of mind and means freedom from any bias. The realization of this requires the use of facts and the lack of involvement of personal feelings, bias, and prejudices. This means that two people with the same level of expertise will achieve the same result in dealing with reality and conditions. Objectivity in auditing means the subjective attitude without bias in an audit work that allows auditors to perform their tasks and programs in a way that they believe in. In other words, objectivity requires auditors to not subject their judgments in audit issues to others. Norms are the informal rules that guide team employee's behaviour. The existence of service quality-oriented norms implies high agreement among team members and increase the involvement with the team working procedures. Wageman (1997) argue that to strengthen team norms, periodical meetings could be organized during which team members' can discuss, for instance, the effectiveness of working procedures.

This paper examines whether audit team norms improve the auditor objectivity. Previous accounting research has, with few exceptions, focused on financial incentives. The few studies of non-financial incentives have found that non-financial factors have a significant impact on auditor objectivity that lie mostly under the surface remaining to be discovered.

This study contributes to the accounting literature in these ways. First, audit team norms have the potential to affect auditor objectivity continuously and thus it may help to reduce both short-tenure and long-tenure risks. The ways to cope with the short-tenure risks have generally been ignored in previous researches. Second, audit team norms are an instrument that could be commanded by management. But most previously considered methods that improve auditor objectivity or reduce the effects of inappropriate client relationships on auditor objectivity cannot be controlled by audit firm management.

Our main results suggest that auditors in firms with stronger team norms make more objective decisions, in terms of non-acceptance of the client's preferred accounting position, than do auditors in audit firms with weaker team norms. In conclusion, our findings indicate that auditors are more likely to make objective judgments in stronger team norms. This result is consistent with Alleyne, Hudaib, & Pike (2013) because they concluded that the extent to which the team expresses similar and strong team norms regarding ethical practices in an organization may affect how an individual member is likely to engage in ethical behavior. Also, the result is consistent with Svanberg & Ohman (2016). They investigate whether audit firm ethical culture is positively related to auditor objectivity. Based on a field survey of 281 practicing auditors employed by audit firms operating in Sweden, the findings indicate that auditors in audit firms with a strong ethical culture are more likely to maintain auditor objectivity than are auditors in less supportive cultures.

Although the results of this study should be interpreted cautiously due to several limitations (e.g. the general limitations of survey research and the way of measuring auditor objectivity using a constructed scenario developed by Svanberg & Ohman (2016), the findings seem important in light of the other mechanisms that regulators have used to enhance auditor objectivity. The goal of most of these methods, including IESBA's Code of Ethics for Professional Accountants, is to inform auditors of the risks arising from strong client relationships. For instance, Iranian audit standards require that auditors assess their relationships with customers and document the potential risks they perceive and that quality assurance measures be initiated based on the outcome of this self-assessment. The problem with this way of dealing with objectivity is that it is difficult for the auditor to explore the causes of judicial bias. In addition to demand that auditors evaluate objectivity threats and auditor rotation, strong audit team norms are an instrument that has not previously been considered in relation to auditor objectivity.

REFERENCES

Alleyne, P., Hudaib, M. & Pike, R. (2013). Towards a conceptual model of whistle-blowing intentions among external auditors. *The British Accounting Review*, *45*(1), 10-23.

Argote, L. (1989). Agreement about norms and work unit effectiveness: Evidence from the field. *Basic and Applied Social Psychology*, *10*(2), 131-40.

Ajzen, I. (1991). The theory of planned behavior. *Organizational Behavior and Human Decision Processes*, *50*(2), 179-211.

Auditing Practices Board (APB). (2011). Ethical Standard. Integrity, Objectivity and Independence.

Bamber, E.M. & Iyer, V.M. (2007). Auditors' identification with their clients and its effect on auditors' objectivity. *Auditing; A Journal of Practice & Theory*, *26*(2), 1-24.

Barker, J.R. (1993). Tightening the iron case: Concretive control in self-management teams. *Administrative Science Quarterly*, *38*(3), 408-437.

Bauer, T. (2015). The effects of client identity strength and professional identity salience on auditor judgments. *The Accounting Review*, *90*(1), 95-114.

Bettenhausen, K.L. & Murnighan, J.K. (1991). The development of an intragroup norm and the effects of interpersonal and structural challenges. *Administrative Science Quarterly*, *36*(1), 20-35.

Bierstaker, J.L., Bedard, J.C. & Biggs, S.F. (1999). The role of problem shifts on auditors' decision processes in analytical procedures. *Auditing: A Journal of Practice & Theory*, *18*(1), 18–36.

Carey, P. & Simnett, R. (2006). Audit partner tenure and audit quality. *The Accounting Review*, *81*(3), 653-676.

Cianci, A.M. & Bierstaker, J. (2009). Auditors' efficiency motivated evaluation. *Advances in Accounting, incorporating Advances in International Accounting*, *25*(1), 20-27.

Chatman, J.A. & Flynn, F.J. (2001). The influence of demographic composition on the emergence and consequences of cooperative norms in work teams. *Academy of Management Journal*, *44*(5), 956-974.

Cohen, S.G. (1994). Designing effective self-managing work teams. In Beyerlein, M.M. & Johnson, D.A. (Eds), Advances in Interdisciplinary Studies of Work Teams: Theories of Self-managed Work Teams. London: JAI Press, 67-102.

De Jong, A., de Ruyter, K. & Lemmink, J. (2005). Service climate in self-managing teams: mapping the linkage of team member perceptions and service performance outcomes in a business-to-business setting. *Journal of Management Studies*, *42*(8), 1593-1620.

Dhaliwal, D.S., Gleason, C.A., Heitzman, S. & Melendrez, D.D. (2008). Auditor fees and cost of debt. *Journal of Accounting, Auditing & Finance*, *23*(1), 1-22.

Feldman, D.C. (1984). The development and enforcement of group norms. *Academy of Management Review*, *9*(1), 47-53.

Glover, S.M., Prawitt, D.F., Wilks, T.J. & McDaniel, L. (2005). Why do auditors over-rely on weak analytical procedures? The role of outcome and precision. *Auditing: A Journal of Practice & Theory*, 24(supplement), 197-220.

Gul, F.A., Fung, S.Y.K. & Jaggi, B. (2009). Earnings quality: Some evidence on the role of auditor tenure and auditors' industry expertise. *Journal of Accounting and Economics*, *47(*3), 265-287.

Hackman, J.R. (1987). The design of work teams'. In Lorsch, J.W. (Ed.), Handbook of Organizational Behavior. Englewood Cliffs, NJ: Prentice-Hall, Inc., 315-42.

Haynes, C.M., Jenkins, J.G. & Nutt, S.R. (1998). The relationship between client advocacy and audit experience: An exploratory analysis. *Auditing: A Journal of Practice & Theory*, *17*(2), 88-104.

Hollingsworth, C., & Li, C. (2012). Investors' perceptions of auditors' economic dependence on the client: Post-SOX evidence. *Journal of Accounting, Auditing & Finance*, *27*(1), 100-122.

Hooks, K.L., Kaplan, S.E. & Schultz Jnr, J.J. (1994). Enhancing communication to assist in fraud prevention and detection. Auditing*: A Journal of Practice & Theory*, *13*(2), 86-117.

International Ethics Standards Board for Accountants. (2015). Handbook of the code of ethics for professional accountants. New York: The International Federation of Accountants (IFAC).

Kadous, K., Kennedy, S.J. & Peecher, M.E. (2003). The effect of quality assessment and directional goal commitment on auditors' acceptance of client-preferred accounting methods. *The Accounting Review*, *78*(3), 759-778.

Knapp, M.C. (1985). Audit conflict: An empirical study of the perceived conflict of auditors to resist management pressure. *The Accounting Review*, *60*(2), 202-211.

Kunda, Z. (1990). The case for motivated reasoning. *Psychological Bulletin*, *108*(3), 480-498.

Narayanan, J.S., Ronson, S. & Pillutla, M. (2006). Groups as enablers of unethical behavior: The role of cohesion on group members' actions. In E. Mannix, & M. Neale (Eds.), *Ethics in groups: Research on managing groups and teams*, *8*, 127-147. UK: JAI Press.

Svanberg, J. & O¨hman, P. (2015). Auditors' identification with their clients: Effects on audit quality. *British Accounting Review*, *47*(4), 395-408.

Svanberg, J. &, O¨ hman, P. (2016). Does Ethical Culture in Audit Firms Support Auditor Objectivity? *Accounting in Europe*, *13*(1), 65-79.

Wageman, R. (1997). Critical success factors for creating superb self-managing teams. *Organizational Dynamics*, *26*(1), 49-61.

Yeatts, D.E. & Hyten, C.C. (1998). High-performing Self-managed Teams: A Comparison of Theory to Practice. Thousand Oaks, CA: Sage.