**PRACTITIONER SUMMARY**

**Practitioner Summary of Can Auditors Reduce Negligence Verdicts? An Examination of Remedial Tactics**

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**SUMMARY:** This article summarizes our recent study, “The Use of Remedial Tactics in Negligence Litigation” (Cornell et al. 2009). Auditors face significant litigation risk when adverse economic events occur with clients, even when the auditors followed Generally Accepted Auditing Standards (GAAS) when they conducted the audit. Civil litigation rules in many U.S. jurisdictions allow plaintiffs to compel testimony from defendants during trial proceedings. We investigated whether auditors could use verbal remediation tactics to reduce the likelihood of guilty verdicts when accused of professional negligence. In a mock trial setting, we examined whether an apology and/or a first-person justification offered by an auditor-defendant results in fewer negligence verdicts against audit firms. Our results indicate that, when an auditor testifies and expresses an apology and/or a first-person justification, jurors find the auditor guilty of negligence about half as often as when no remedial tactic is used. These findings provide evidence that auditors accused of negligence may effectively utilize such tactics to defend their audit decisions and actions.

**Keywords:** auditor litigation; remedial tactics; apology; justification.

**INTRODUCTION**

We summarize our recent study, “The Use of Remedial Tactics in Negligence Litigation,” published in Contemporary Accounting Research (Cornell et al. 2009; hereafter “our study” or “the study”). We discuss the background and motivation of the study, research methods, a summary of the results, and implications for auditors. The results contribute to the expanding auditor-negligence litigation literature and should be of interest to both practitioners and academics.

**BACKGROUND AND MOTIVATION**

An ongoing problem affecting the auditing profession is a gap between the assurances that auditors provide and expectations of financial statement users (i.e., the expectations gap). When

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1 See McEnroe and Martens (2001) and Taub (2005) for more detailed discussions of the expectations gap.
this gap is combined with economic losses by third parties such as investors, lawsuits against auditors often result. As litigation-related expenses continue to increase for accounting firms, auditors remain concerned with the economic and reputation effects of ongoing litigation threats.

The auditors’ concerns appear justified as the legal costs of the Big N auditing firms represented 9 percent of their domestic auditing revenues in 1991 (Cook et al. 1992), 14.2 percent of revenues in 2004 (Melnitzer 2007), and 15.1 percent of revenues in 2007 (Center for Audit Quality [CAQ] 2008). In fact, the CAQ (2008, 31) suggests that “auditors face liability exposure dramatically more onerous than any other type of business.”

Legal standards state that auditors’ work should be evaluated based on their adherence to Generally Accepted Auditing Standards (GAAS), and not on firm-specific outcomes unrelated to the audit. However, when investors experience a harmful event (e.g., a significant loss in company value), they often seek remuneration from auditors because of perceived auditor greed, incompetence, or neglect of professional duties.

Research in accounting has demonstrated that outcome knowledge and “Monday-morning quarterbacking” distorts the intent of the legal system by causing both judges (Anderson et al. 1997) and jurors (Lowe and Reckers 1994; Kadous 2000, 2001) to focus on the outcomes of prior decisions and not on compliance with applicable professional standards. That is, when determining guilt, judges and jurors focus on the loss that a company or individual has suffered rather than on the audit procedures that were performed.

In our study, we examined, in an auditor litigation setting, the effect of two remedial tactics (apology and first-person justification). Remedial tactics are defined as specific verbal responses to incidents with negative outcomes (Goffman 1961, 1967) that can be used to influence impressions of prior actions. Remedial tactics do not change the facts and circumstances surrounding an event, but rather are intended to diminish the effect of outcomes on evaluations made in hindsight.

The use of remedial tactics is not new in combating unfounded negligence claims. For over a decade, physicians faced with malpractice litigation have effectively employed apologies when communicating with patients and patients’ families (Berwick 2003; Wu and Pronovost 2003; Lamb 2004; Zimmerman 2004). Research on the effectiveness of apologies in medical malpractice cases shows that this remedial tactic is quite effective at reducing litigation in health care organizations such as individual hospitals (Wu 1999; Robbennolt 2003; Mazor et al. 2004; Wu et al. 2009). Furthermore, incidences of malpractice litigation have decreased in states where apology laws have been enacted (Ho and Liu 2010).

However, remedial tactics in medicine differ from auditor litigation settings because (1) auditors do not have direct contact with the harmed party (e.g., investors), but instead they interact with an unharmed juror in a trial setting; (2) alleged auditor negligence results in economic damages and not injury or death; and (3) the decrease in medical malpractice claims occurs before a negligence trial and not during a trial, as might be the case with the auditor.

An apology is a communication of sorrow, regret, or penitence about an incident offered without admitting wrongdoing (Tanick and Ayling 1996; Taft 2000), and it works to facilitate healing for victims (Weiner 1986, 1995; Taft 2000). Offering an apology can be accomplished without admitting guilt or fault. Kanazawa (2004, 32) summarizes how an apology differs from an admission of wrongdoing:

First, an apology is not necessarily equivalent to the admission of liability. “I’m sorry” is not the same as “I’m at fault.” “I’m sorry,” is polite and human. Not to say, “I’m sorry” is rude and arrogant. It has nothing to do with fault. Moreover, “I’m sorry” in everyday
speech usually means, “I’m sorry we find ourselves in this current situation.” It is not about fault.

In fact, some states have passed statutes that protect apologies from being introduced in court as evidence of wrongdoing or an admission of guilt. In 1986, Massachusetts became the first state to pass a law protecting apologies from being introduced in court to suggest guilt (Robbennolt 2003). By 2009, 36 states had some form of “apology law” (Ho and Liu 2010).

During civil litigation in most jurisdictions in the United States, plaintiffs can compel defendants to testify during the trial, regardless of whether the defendant wishes to testify in his or her own defense. This structural mechanism of the legal system perhaps, at least partially, explains why many allegations of negligence are settled before an actual trial commences. Remedial tactics provide defendants with two mechanisms that can be used in a trial or other setting when a response to allegations is necessary.

First-person justifications offer the opportunity for defendants to provide an account of why decisions were made. They differ from related legal defense strategies that rely on expert witnesses who testify about the correctness of defendants’ actions. A first-person justification is defined as a verbal statement used by the accused to communicate the appropriateness, reasonableness, or necessity of decisions made under uncertain conditions. It indicates that a reasonable person, in similar circumstances, would have acted in a like manner (Diekmann et al. 1997). Research indicates that justifications are most effective when an “audience feels the account describes the real reason for the action” (Riordan et al. 1983, 214).

Although a first-person justification may not present new factual evidence (Blumstein et al. 1974), the mechanism provides specific insight into decision-making processes directly from the defendant. When a first-person justification effectively conveys to jurors the appropriateness of the auditor’s decisions given the circumstances, jurors may change their impressions of the auditor’s actions. Although apologies and first-person justifications operate in different ways, both help modify impressions resulting from harmful outcomes. We investigated these issues by conducting an experiment.

RESEARCH METHOD

We conducted an experiment using 139 jury-eligible adults as participants. Based on feedback from an attorney who frequently litigates civil liability cases, we excluded lawyers and accountants because it is highly unlikely they would be selected to serve as jurors in a similar case. Our final sample included potential jurors from nine different states, with ages ranging from 19 to 66 years. Participants had diverse educational, socioeconomic, and geographic backgrounds. Prior to starting the study, each participant was randomly assigned to one of four conditions.

Participants first read instructions about the format of the study and were instructed to put themselves in the position of jurors in a negligence court case. The plaintiff in the case was an

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2 Suspects and defendants in criminal cases have the Fifth Amendment right to remain silent during questioning by police, interrogation, and trials. In most jurisdictions, the rules regarding defendant testimony in civil cases are quite different. In civil litigation, defendants must be available and cooperative for depositions and other forms of evidence discovery, and even provide plaintiffs with names and contact information for others who may possess relevant documentation related to the allegation. In fact, defendants may be called to testify by the plaintiff in civil litigation, even if the defendant plans to invoke the Fifth Amendment privilege to not incriminate him/herself. In many jurisdictions, the invocation of the Fifth Amendment by a defendant can be used explicitly as an indication of culpability in civil proceedings.
investor who suffered significant losses. The auditor issued an unqualified opinion, and the plaintiff
alleged that the auditor acted negligently by failing to discover fraud; specifically, the management
of the audit client had intentionally misstated inventory. The plaintiff alleged that the audit firm’s
negligence also resulted in a creditor losing significant money, bankruptcy for the audit client, and
job losses for the client’s employees. The case consisted of the following items: the plaintiff’s
complaint; the respondent’s answer; both the plaintiff’s and defendant’s attorneys’ opening and
closing statements; witness testimony; testimony from one expert witness for each side; the
judge’s instructions to the jury; and, in three of the four conditions, the audit partner’s testimony,
and responses to cross-examination.

In the first condition, the auditor did not testify, so there was no remedial tactic (apology or
justification). In the apology condition, the audit partner apologized for the negative outcomes
mentioned in the case without accepting responsibility, admitting guilt, or providing any additional
information about the dispute. To ensure that the jurors attended to the auditor’s apology, the
defense attorney also made reference to the audit partner’s apology during the closing statement.
In the first-person justification condition, the auditor justified the firm’s actions taken during the
audit. The audit partner did not provide any new facts concerning the dispute. Instead, the
partner briefly defended the propriety of the firm’s decisions. Similar to the apology condition, the
defense attorney mentioned the auditor’s justification during the closing statement. In the fourth
condition, the auditor provided both an apology and a first-person justification of previous
decisions and, as in the apology alone and the justification alone, the attorney mentioned both in
closing arguments. Participants read the case transcript and provided a guilty or not guilty verdict.
Participants also answered questions regarding the trial and provided demographic information.

RESULTS

Our results indicate that, when an auditor testifies in a civil lawsuit and expresses an apology
and/or a first-person justification, jurors are less likely to find the auditor guilty of negligence. When
the auditor did not testify (no apology or justification), jurors found the auditor guilty 47 percent of
the time. Testifying and offering an apology dropped the likelihood of a guilty verdict to 24 percent.
However, testifying and offering a first-person justification decreased the level to 17 percent. When
both an apology and justification are offered together, 26 percent of participants rendered a guilty
verdict. 3

To better understand the effect of an apology, we asked the jurors to indicate the importance
determining who is to blame for the outcomes. Participants in the apology condition had a much
lower need to assign blame than those who received no apology or justification, suggesting that
negligence judgments are affected by an apology. To determine whether participants judged the
apology as an indication of guilt, we asked participants to judge the extent to which the auditor
accepted responsibility (liability) for the audit failure and found that participants did not believe that
the auditor either accepted responsibility or accepted liability for the negative outcomes.

A first-person justification allows the accused to explain the reasonableness of actions given
prior circumstances. This tactic should cause jurors to view the auditors’ actions as more
appropriate. To investigate this concept, participants assessed the auditor’s responsibility to

3 The rate of guilty verdicts in the apology group (24 percent), the first-person justification group (17 percent), and
the both-tactics group (26 percent) were all significantly less than the guilty rate for the control group (47 percent).
The rate of guilty verdicts for the three remedial tactics groups (i.e., apology, first-person justification,
and both tactics) were not statistically different from each other.
discover small errors in financial statements. We found that jurors receiving the audit partner’s first-person justification reported significantly lower assessments (when compared to the control group) of “auditors’ responsibilities to detect small misstatements in financial statements.”

To further examine the effects of offering both remedial tactics, we investigated the jurors’ need to assign blame for the negative outcomes and their perceptions of the auditors’ professional responsibilities. We found that the combination of the two tactics did not significantly lower jurors’ need to assign blame compared to the group exposed to only one tactic (either the apology or the justification). Also, when compared to jurors exposed to only one tactic, the combination of apology and justification did not significantly affect participants’ judgments of auditors’ professional responsibility to discover immaterial misstatements.

**CONCLUSIONS AND IMPLICATIONS**

The results of our study have the potential to affect how accounting firms address litigation. Our results suggest that, when a lawsuit reaches a courtroom, auditors could utilize strategies to help them prevail. Events surrounding a business failure involve dramatic losses—layoffs, community and political distress, investor and debt-holder damages, etc. While plaintiff attorneys almost certainly will use such outcome information to persuade jurors, our results indicate that, when accused of negligence, auditor-defendants can use remedial tactics to reduce biased evaluations of their past actions. In our study, the likelihood of negligence verdicts against auditors was cut in half when a remedial tactic was incorporated into trial testimony.

While our findings examine jurors’ verdicts, we suggest other possible implications. The decision to file a lawsuit is often based on a cost-benefit analysis. For plaintiffs seeking financial benefits, the decision to litigate is generally based on the expected payoff of an out-of-court settlement or jury award. Consequently, the use of remedial tactics may benefit auditors outside of the courtroom. Specifically, the ability to use remedial tactics could cause plaintiffs to settle a case for less money, or perhaps such tactics could prevent potential plaintiffs from pursuing litigation altogether. Recent research in medical malpractice suggests that such possibilities have merit. Ho and Liu (2010) find that apology laws reduce the average medical malpractice settlement and lead to a faster resolution of cases. Further, the authors find lower malpractice claims against doctors for minor injuries because of apology laws.

Our study examined litigation following an audit failure, but the results may apply to other types of conflicts. For example, conflicts between employees, allegations of discrimination, and workplace injury claims may result in litigation against professional accountants. Defusing emotional situations and offsetting hindsight bias by offering an apology and/or justifying prior decisions may prevent the escalation of such events. Such resolutions potentially could reduce an accounting firm’s litigation exposure.

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4 We investigated whether using both tactics together reduces the effectiveness of each tactic used alone by examining how jurors perceived the sincerity of the apology. Jurors’ assessments of the apology’s sincerity did not differ significantly when the auditor expressed only an apology compared to jurors who received both an apology and justification. For jurors exposed to both the justification and apology, we investigated whether they perceived the combination of an apology with a justification as excuse making; we found no differences between the justification condition and those receiving both remedial tactics.
REFERENCES


