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The Effect of Expanded Audit Report Disclosures on Users' Confidence in the Audit and the Financial Statements

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The Effect of Expanded Audit Report Disclosures on Users' Confidence in the Audit and the
Financial Statements

by

Peter Christopher Kipp

A dissertation submitted in partial fulfillment
of the requirements for the degree of
Doctor of Philosophy in Business Administration
with a concentration in Accounting
Lynn Pippenger School of Accountancy
Muma College of Business
University of South Florida

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Keywords: Critical Audit Matters, Standard Audit Report, Investor's Perception, Audit Quality,
Support Theory, PCAOB

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DEDICATION

I would like to dedicate this dissertation to my father and mother, Steven and Marilyn Kipp. My parents instilled a love of learning in me at a very young age and always made sure I had their unwavering support in all of my pursuits. I thank my father for teaching me the value of hard work and to always push forward. I thank my mother for teaching me the value of humility and service to others and to never forget where I came from. I would also like to thank my brother, Andrew Kipp, for being my best friend since we were kids and for his enthusiastic support. Their dedication, lessons, and love have helped me arrive where I am today and hope I can express my appreciation in the years to come

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ABSTRACT

I investigate how nonprofessional investors' confidence in the financial statements and the audit report is influenced by the firm specific details of a critical audit matter (CAM) disclosure in conjunction with the description of the audit procedures engaged to address the CAM in the audit report. Using participants recruited from Amazon Mechanical Turk as a proxy for nonprofessional investors in a 2x2 +1 (control) between-participants experiment manipulating CAM disclosure detail (Detailed/Generic) and the description of the audit procedures engaged to address the CAM (Detail/Generic) I find that greater detail in the description of the CAM results in higher confidence in the accuracy and reliability of the financial statements than a generic description of the CAM, consistent with boundary condition of Support Theory. Further, I find that greater detail in the description of the related audit procedures engaged to address the CAM *increases* nonprofessional investors' perceptions of audit quality. Evidence of an effect of CAM and audit procedure disclosure language on investment judgments is also presented. These results have implications for researchers, practitioners, and regulators to carefully consider the language used to disclose CAMs in the auditor's report.

Keywords: Critical Audit Matters, Standard Audit Report, Nonprofessional Investors' Perception, Audit Quality, Support Theory, PCAOB

Data availability: *Contact the author*

1. INTRODUCTION

The Public Company Accounting Oversight Board (PCAOB) has recently proposed new rules for auditors of U.S. issuers that will mandate the disclosure in the audit report of critical audit matters (CAMs) which are those issues identified during the audit that required the auditor's significant judgment (PCAOB 2016). The goal of the PCAOB's standard setting process is to address the lamented lack of content in the auditor's report highlighted by Church et al. (2008). Church et al. (2008) concluded from their review that the audit report possesses symbolic value but does a poor job of communicating useful information to financial statement users.

Contemporary research has investigated how jurors, legal experts, and analysts view the disclosure of CAMs in light of litigation against the auditor (Backof et al. 2015, Bedard et al. 2015, Brown et al. 2014, Gimbar et al. 2016, Kachelmeier et al. 2016, Kadous et al. 2015) and has generally found that the disclosure of a CAM leads to a "disclaimer effect" (Heymann 2010). The findings suggest that a CAM disclosure serves as a warning that the user of the financial statements should carefully consider what they are about to consume from the financial reports. This is despite the auditor providing reasonable assurance on the financial statements as a whole. Other experimental research has shown that the presence of a CAM in the audit report discourages investment in the firm (Christensen et al. 2014) or have found no effect on participants' investment decisions (Carver and Trinkle 2016).

Despite this prior research, little evidence exists illustrating *how* the language¹ (e.g. firm specific factors, language valence, granularity of description, etc.) with which a CAM is disclosed in the audit report influences nonprofessional investors' confidence in the underlying figures. This is an important question to investigate given the PCAOB's election of a principles-based framework for the auditor to accomplish their new mandate. This principles based framework suggests that the auditor may disclose any level of detail they deem appropriate as long as they fulfill four obligatory disclosures.

A second dimension of the PCAOB's proposed standard unaddressed in prior research is the mandatory disclosure of the auditor's response to the CAM. This novel regulation would give the users of financial statements insight into the audit procedures performed to attain assurance on the assertions underlying the account in question. This would include information that the investing public has not been privy to before. As stated in the PCAOB's re-proposed rule, the communication of a critical audit matter would include: 1) identifying the critical audit matter, 2) describing the principal considerations that led the auditor to determine that the matter is a critical audit matter, 3) describing how the CAM was addressed in the audit, and 4) referring to the relevant financial statements accounts and disclosures (PCAOB 2016, Page 13).

Despite these regulatory proposals, the PCAOB explicitly states that assurance provided on the financial statements should remain at the same level as before and piecemeal assurance,

¹ This dearth of research is unsurprising considering the standard audit report has remained boilerplate and unchanged in its informational content since SAS No. 58 (AICPA 1988a). The PCAOB's re-proposed regulation opens up significant research opportunities into the language of the audit report on how different language characteristics and detail could have a differential effect on investor judgments and investment decisions. Anecdotally, audit reports of issuers in the U.K. vary considerably in the depth of content and description of key audit matters (KAMs). The Financial Reporting Council encourages auditors to add their own observations and to be as descriptive as possible in their KAM disclosure (FRC 2013). The PCAOB itself states that the FRC requirements are used for comparison to its own standard setting process for the CAM initiative (PCAOB 2016, Page 11).

nor language suggestive thereof, will not be tolerated in the auditor's report. Actual audit quality remains unobservable; therefore, perceptions of audit quality inform individuals' view of reality and impact their judgments and decisions (Smith and Minter 2005). The upcoming changes to the regulatory environment highlight the importance of research in this area to determine how the new disclosures will be impact the perceptions of audit and financial reporting quality of different investing populations, including nonprofessional investors. In light of these new regulatory developments, it is important to determine how nonprofessional investors perceive the manner in which a CAM is disclosed along with the audit procedures engaged to address the CAM.

This study examines the following research questions: 1) how does the PCAOB's principles-based framework for the communication of CAMs, specifically the level of detail used to describe the CAM disclosure, impact nonprofessional investors' confidence in the accuracy and reliability of the financial statements as a whole, 2) how does the description of the related audit procedures in the audit report moderate nonprofessional investors' assessments of audit quality, 3) do these two disclosures interact to jointly impact nonprofessional investors' confidence in the financial statements and assessments of audit quality, 4) are nonprofessional investors' assessments of misstatement influenced by the new disclosure, and 5) how are nonprofessional investors' investment decisions impacted by the changes to the standard audit report?

This research is important because, despite the additional disclosure of CAMs and audit procedures in the audit report, the level of assurance provided on financial statements will

remain the same and the new proposal does not require additional audit testing or procedures beyond what is already being completed on the audit engagement². The only factor that could be influenced by these additional disclosures is *perceptions* of audit quality and *perceptions* of financial reporting quality. Currently, little evidence exists indicating how investors will utilize an expanded audit report³ consisting of CAM disclosures and the related audit procedures when evaluating the financial statements of investment prospects and whether their perceptions of audit quality and confidence in the financial statements will be impacted. This research contributes to the literature by investigating under what circumstances the details of a CAM disclosure in conjunction with the detail of the related audit procedures specific to the firm influences nonprofessional investors' confidence in the financial statements and the auditor's work.

The information required to answer these questions is not available in existing archival datasets in the United States⁴; therefore, the effect of CAM disclosure and audit procedure

² Specifically, the PCAOB states in their re-proposed rule that “the re-proposed standard is intended to respond to investor requests for additional information about the financial statement audit by increasing the relevance and usefulness of the auditor’s report, without imposing requirements beyond the auditor’s expertise or mandate.” (PCAOB 2016, Page 2). This statement suggests that the only area of additional compliance for the auditor would be the disclosure requirements laid out in the standard and no additional testing or evidence collection would be required beyond what is presently expected of the auditor.

³ Two contemporaneous studies investigate similar research questions. Sirois et al (2014) employs eye-tracking technology to investigate how users of the auditor’s report navigate through the additional key audit matter (KAM) disclosures. Carver and Trinkle (2016) study how the proposed standard impacts nonprofessional investors’ valuation judgments and find that the inclusion of a CAM does not impact valuation judgments. I expand upon these previous studies by investigating how the principles-based framework laid out by the PCAOB in their re-proposed rule could communicate identical CAM accounts to investors with variable levels of detail. This variable level of detail could result in differential judgments of perceived audit quality and perceived financial reporting quality, impacting investment decisions.

⁴ As will be discussed later, several international jurisdictions have mandated disclosures synonymous with the PCAOB’s CAMs. The Financial Reporting Council in the United Kingdom has mandated the external audit disclose Key Audit Matters (KAMs) in their audit reports (FRC 2013). The revised standard requires the auditor’s report to disclose a description of risks of material misstatement and how the audit addressed each of these risks. The format of these disclosures in the audit reports differ significantly from firm to firm and auditor to auditor. By conducting an experiment with nonprofessional investors trained in U.S. GAAP and familiar with U.S. laws and regulations as

disclosure on nonprofessional investors' confidence in the results of the audit and the contents of financial statements may only be obtained experimentally. The findings will be of interest to researchers, practitioners, and regulators as the PCAOB develops this standard in determining what expanded audit report disclosures are most valuable to nonprofessional investors in informing their confidence in the underlying accounts and the audit. Practitioners will be interested in how the different paths the auditor may use to comply with their new mandate can differentially impact nonprofessional investors' judgments and investment decisions. Company management will be interested in the results if the language chosen by the auditor to disclose CAMs impacts nonprofessional investors' investing decisions, thereby giving management an incentive to influence the disclosure process and the language contained therein.

To investigate my research questions, I conduct a $2 \times 2 + 1$ (control) between-participants experiment using participants recruited via Amazon Mechanical Turk as a proxy for nonprofessional investors⁵. The independent variables manipulated include the detail of a critical audit matter disclosure in the audit report at two levels (Detailed/Generic) and the description of the audit procedures engaged to address the CAM at two levels (Detailed/Generic). Participants were asked to view summary financial information regarding two fictitious financial service firms and were then exposed to the experimental manipulation in a summarized auditor's report. My dependent variable measures included: confidence in the

participants, I am able to observe a clearer portrait of how these disclosures would influence nonprofessional investors active in U.S. equity markets. Further, I am able to tease out granular features of the re-proposed rule to determine what new disclosures will impact nonprofessional investors' judgments and how the features interact with one another to impact nonprofessional investors' judgments.

⁵ Amazon Mechanical Turk is a digital labor marketplace where workers voluntarily review Human Intelligence Tasks (HITS) to determine whether or not to participate for compensation. Prior research in accounting has utilized participants recruited via Amazon Mechanical Turk as a proxy for nonprofessional investors (e.g. Rennekamp 2012, Brown et al. 2014, and Brasel et al. 2016). Additional research by Farrell et al. (2017) shows that participants recruited from the Amazon Mechanical Turk platform as at least as honest and exert similar levels of effort to participants used in prior research to proxy for nonprofessional investors.

accuracy of the account disclosed as a CAM, confidence in the accuracy of the financial statements as a whole, assessments of auditor competence and audit quality, likelihood of material misstatement, and an investment decision between the two competing firms. The audit report of the control condition only contains a statement that no CAMs were identified or disclosed in the current engagement and does not contain a manipulated audit report for comparative purposes.

For this research, I rely upon theory from psychology to motivate my investigation and hypotheses. Specifically, I utilize literature from Support Theory. Support Theory (Tversky and Koehler 1994, Rottenstreich and Tversky 1997, Sloman et al. 2004) suggests that an individual does not assess the probability of an event directly, but assesses the support for the underlying hypothesis or description of the event. In my experimental context, when an event (CAM disclosure) is described in greater detail and specificity, such as listing the specific considerations that led to the determination of a CAM or the details of the audit procedures engaged to address the CAM, a nonprofessional investor will assess the probability of the event (e.g. unreliable/inaccurate account in the case of a CAM, higher/lower audit quality in the case of the related audit procedures) as more likely to occur. This phenomenon is due to the individual's (e.g. nonprofessional investor) effortful evaluation of the separate pieces of evidence and details surrounding the event rather than judging the probability of the event itself⁶. In other words, as greater detail is provided to the individual (nonprofessional investor) regarding the event, he will

⁶ An easily accessible of Support Theory may be found in Tversky and Koehler (1994). In their experiment, Tversky and Koehler (1994) asked participants to evaluate the probability of death by natural causes and unnatural causes, two mutually exclusive hypotheses. Participants evaluated the probability of each hypothesis as 58% and 32%, respectively. The experimenters then asked participants to evaluate the probability of death due to heart disease, cancer, or other natural causes (which are all subsets of death by natural causes); the probabilities for each of the subsets were 22%, 18% and 33% which summed to 73%, a significantly higher probability assessment than 58%.

assess the probability of the event to be higher than if generic details were provided in the description.

Support Theory is subject to a boundary condition; as demonstrated in Sloman et al. (2004) if the pieces of supporting evidence are less typical, such as detailed factors that led to the determination that the account is indeed a CAM, individuals will view the detailed evidence as support for a rare event and therefore judge the probability of the event (unreliable/inaccurate account) to be lower, a phenomenon referred to as superadditivity⁷.

Based on the boundary condition of Support Theory, I predict that more detailed descriptions of the CAM account will result in higher assessments in the reliability and accuracy of the CAM account. Similarly, I expect that detailed descriptions of the audit procedures will increase nonprofessional investor's confidence in the audit report and perceptions of audit quality. Finally I predict, based on Support Theory (Tversky and Koehler 1994, Sloman et al. 2004) that additional detail in a CAM disclosure will *increase* nonprofessional investors' perceptions of financial reporting quality by providing additional, atypical evidence of why the underlying account is uncertain and subjective.

The results of the study provide support for my hypotheses. Consistent with the boundary condition of Support Theory, when a CAM is disclosed in greater detail, nonprofessional investors' confidence in the accuracy and reliability of the disclosed account

⁷ In the context of Support Theory (Tversky and Koehler 1994, Sloman et al. 2004) subadditivity refers to the phenomena where an unpacked description of an event/item (e.g. value of an insurance policy covering heart attacks, cancer, or any other disease) is judged to be greater than a packed description of the same event/item (e.g. value of an insurance policy covering any disease). In contrast, superadditivity refers to the phenomena where an unpacked description of an event/item (e.g. value of an insurance policy covering cirrhosis, pneumonia, diabetes, or any other disease) that contains very specific or atypical evidence support the event is judged to be lower than a pack description of the same event/item (e.g. value of an insurance policy covering any disease) (Sloman et al. 2004).

increases. Further, assessments of audit quality and auditor competence increase when the audit procedures disclosed in the audit report are disclosed in greater detail than when they are disclosed in generic detail. Finally, I find that the levels of CAM disclosure detail and audit procedure detail interact to significantly increase investment in the disclosing client firm, suggesting that the changes to the audit report are perceived as useful and informative by nonprofessional investors.

This study contributes to the literature in several ways. First, this study is one of the first experiments to document nonprofessional investors' perception of CAM disclosure and the related audit procedures and how these disclosures influence confidence in the financial statements and the audit report. Without implementation of the recent PCAOB re-proposal it will be difficult if not impossible for nonprofessional investors to acquire any meaningful data concerning the details of the audit and audit procedures. As noted by Coram (2010) it is challenging to examine how a particular group of investors will behave through market-based, archival studies; an experiment has the benefit of examining the behavior of this specific population (Clor-Proell et al. 2014, Libby et al. 2015) and teasing out the parts of a regulatory environment that does not yet exist in practice to observe which parts of the proposal will have the most significant impact on nonprofessional investors' judgment. This research documents that the PCAOB's proposed standard does have a significant, differential impact on nonprofessional investors' judgments.

Second, this study contributes to the literature by analyzing how nonprofessional investors' confidence in the financial statements is impacted by the language of the CAM disclosure and the disclosure of related audit procedures where more/less details in the disclosure will lead to differential perceptions of financial reporting quality and audit quality. Third, this

study suggests that nonprofessional investors' perception of audit quality is impacted by the disclosure of audit procedures in the audit report despite actual levels of assurance quality remaining unchanged. Finally, supplemental analysis shows that the disclosure of the CAM and related audit procedures significantly impacts investment in the client firm, suggesting that the information contained within the disclosure is perceived as valuable by nonprofessional investors making investment decisions.

This paper is organized as follows: Section 2 provides a review of the relevant literature and theory, Section 3 discusses the hypotheses development, Section 4 describes the experimental methodology, Section 5 provides tests of hypotheses and explain the results, Section 6 provides a discussion of the supplemental analyses, Section 7 provides a discussion of my experimental findings, and Section 8 presents conclusions, implications, limitations, and opportunities for future research.

2. LITERATURE REVIEW & THEORY

This section provides a review of relevant accounting literature and theory. In order to answer my research questions, this study employs the Support Theory (Tversky and Kohler 1994) and the boundary condition of Support Theory (Sloman et al. 2004) to motivate testable hypotheses.

2.1 Auditing Standards

Under current SEC reporting rules, an external financial statement audit performed by an independent auditor is required for all issuers who are listed on U.S. exchanges. The SEC specifically requires that all firms listed on exchanges in the U.S. are issued an unqualified opinion to remain listed on the exchange. These regulatory restrictions have resulted in an environment where the standard auditor's report is boilerplate in nature and symbolic in its value to nonprofessional investors (Cohen Commission 1978, Church et al. 2008, Carcello 2012, Mock et al. 2013, Carver and Trinkle 2016). Qualitative investigations have shown that the majority of nonprofessional investors only briefly review the auditor's report to verify that the opinion is unqualified and to look for any language that would be a departure from a boilerplate disclosure (Gray et al. 2011, Mock et al. 2013).

The uninformative and boilerplate nature of the standard auditor's report have led investors and other users to demand significant changes to enhance the information content and the value of the message communicated through the auditor's report (e.g. CFA Institute 2011). The most recent proposals to overhaul the standard audit report began in 2003, when the 103rd American Assembly proposed variable levels of assurance on different accounts within the financial statements based on the level of subjectivity in those accounts (The American Assembly 2003). The U.S. Department of Treasury Advisory Committee on the Auditing Profession recommend that the SEC and PCAOB adopt a standard setting agenda to reform the standard audit report and include additional information to the user of the audit report (ACAP 2008). The Certified Financial Analysts (CFA) Institute, in its annual survey of members, has frequently and repeatedly lobbied for an expanded audit report that includes specific information about the auditor, information concerning how the auditor came to their opinion, information on materiality level for the audit engagement, and information on areas that are subject to higher risk (CFA 2008, 2010, 2011). Carver and Trinkle (2016) note that despite these outcries for significant revision to the auditor's report, the report has effectively remained unchanged in its content and presentation since 1948 (Mock et al 2013), with the most recent change to the audit report coming in the form of SAS No. 58, *Reports on Audited Financial Statements*, in April 1988 (AICPA 1988a) which eliminated the "subject to" qualification of opinions.

To respond to continued investor dissatisfaction with the contents of the standard audit report, the PCAOB adopted several regulatory initiatives (e.g. Reid et al. 2015, Turner et al. 2010, Blake et al. 2011). To inform their standard setting process the PCAOB surveyed members of its Investor Advisory Group. The majority of respondents to a PCAOB Investor Advisory Group survey stated their belief that the audit report should contain information about

the areas of the audit that pose the greatest financial statement and audit risk and the procedures completed to reduce these risks (Reid et al. 2015), prompting the PCAOB to produce a rule that would address these concerns.

2.2 Proposed PCAOB Changes to the Audit Report

The Public Company Accounting Oversight Board (PCAOB) has been engaged in revising the content and form of the standard audit report to address investor concerns about the transparency of the audit engagement and the informativeness of the audit report (PCAOB 2013) and has released several concept releases and proposed rules to address the issue (PCAOB 2011, PCAOB 2013, PCAOB 2016). In response to the report issued by the US Department of Treasury Advisory Committee on the Auditing Profession (ACAP 2008) the PCAOB adopted a standard setting initiative to increase the informativeness of the standard audit report for investors and other users.

The PCAOB began its standard setting initiative by promulgating a concept release in June 2011 titled *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements* (PCOAB 2011). The concept release included a proposal for an addendum to the auditor's report framed as an auditor's discussion and analysis (AD&A). The proposal was applauded by investors and investor advocacy groups, but was met with significant resistance by preparers and practitioners. The major concern of preparers and practitioners was that the AD&A would result in the auditor encroaching on management's responsibility as the source of new information, would promote decreased communication between the auditor and the audit committee, and have the unintended consequences of reducing overall audit quality (PCAOB 2010a, PCAOB 2010b, PCAOB 2011b)

Cognizant of the criticism of the 2011 concept release, the PCAOB proposed a new auditing rule in August 2013 titled *Proposed Auditing Standards – The Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion* (PCAOB 2013). At the core of the 2013 proposed rule were critical audit matters that would be communicated within the auditor’s report rather than a separate commentary by the auditor. As PCAOB Chairman James R. Doty stated, the changes were motivated to “make the auditor’s report more relevant to investors” (PCAOB 2013b, paragraph 3).

The 2013 proposed rule was, again, met with stiff resistance from preparers who argued that the disclosures of CAMs in the audit report would not achieve the objective of making the auditor’s report more informative for investors. The argument that CAM disclosure would confuse users of who was the responsible party for disclosing novel information (management or the auditor) resurfaced and concerns of a chilling effect between the auditor and the audit committee were resurrected (PCAOB 2014a, PCAOB 2014b). Further, the language within the proposed rule left a significant amount of room for auditor judgment on what accounts were and were not to be disclosed as critical audit matters, leading preparers to argue that the number of accounts that would need to be disclosed as CAMs would again render the audit report meaningless through the sheer volume of information (PCAOB 2014a, PCAOB 2014b).

Most recently, the PCAOB re-proposed a rule mandating critical audit matter (CAM) and audit procedure disclosures in the auditor’s report in a May 2016 release (PCAOB 2016). The re-proposed rule retained the requirement for disclosure of CAMs in the audit report, but limited the definition of CAMs as “any matter that was communicated or required to be communicated to the audit committee and that: relates to accounts or disclosures that are material to the financial statements, and involved especially challenging, subjective, or complex auditor

judgment” (PCAOB 2016, Page 3). The clarification of the definition of a CAM is in response to concerns of a chilling effect of communication between the audit committee and the auditor by limiting the accounts that can be disclosed as a CAM as those that are already required to be communicated to the audit committee. The audit committee⁸, acting as an oversight of the audit and representing the best interests of stakeholders, was reasoned to be an appropriate starting point for the determination of a CAM (PCAOB 2016). The requirement that the matter be material makes it more objective for the auditor to determine what accounts would constitute a critical audit matter and would eliminate the possibility that too many CAMs are considered by the auditor and communicated in the auditor’s report (PCAOB 2016).

Specifically included in the PCAOB’s May 11, 2016 proposed rule is the mandatory disclosure of a critical audit matters (CAMs) paragraph⁹ to detail those matters encountered during the audit that were especially challenging, subjective, or complex¹⁰ and how the auditor responded to these matters (PCAOB 2016). The PCAOB expects that typical CAM areas will

⁸ Under current PCAOB standards, the auditor is required to communicate the following items to the audit committee: 1) significant risks identified by the auditor, 2) certain matters regarding the company’s accounting policies, practices, and estimates, 3) significant unusual transactions, 4) certain matters regarding the auditor’s evaluation of the company’s relationships and transactions with related parties, and 5) other matters arising from the audit that are significant to the oversight of the company’s financial reporting process (PCAOB 2016, Page 18-19).

⁹ In the PCAOB’s proposal, critical audit matters (CAMs) would be disclosed following the opinion paragraph in the audit report but before the auditor’s signature (PCAOB 2016). The first paragraph of the CAM disclosure would explain the nature of CAMs in general and explicitly state that the CAMs identified do not alter the opinion provided by the auditor on the financial statements. The paragraphs following this introductory paragraph would then list the CAMs identified, how the auditor determined the item was a CAM, and any relevant procedures and audit testing used to increase the auditor’s confidence in the subject matter affected by the CAM.

¹⁰ The PCAOB re-proposed rule lists several factors for the auditor to consider before disclosing an account as a CAM in the auditor’s report (PCAOB 2016). These factors include: 1) the auditor’s assessment of the risks of material misstatement, 2) the degree of auditor subjectivity in determining or applying audit procedures to address the matter or in evaluating the results of those procedures, 3) the nature and extent of audit effort required to address the matter, 4) the degree of auditor judgments related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty, 5) the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions, 6) and the nature of audit evidence obtained regarding the CAM (PCAOB 2016, Page 12-13).

include “significant management estimates and judgments made in preparing the financial statements; areas of high financial statement and audit risk; unusual transactions; and other significant changes in the financial statements” (PCAOB 2016, 2). Comment letters originating from investors claim that the inclusion of CAMs in the audit report would help increase the credibility of the audit (e.g. CFA 2011) and could serve as an attention director when evaluating the reliability of the financial statements.

Of particular note in the PCAOB’s 2016 re-release is the principles-based framework that would be used to determine CAMs by leveraging work already performed by the auditor under the existing PCAOB rules and standards (PCAOB 2016). The PCAOB states that “[d]epending on the matter, the auditor’s determination that a matter is a critical audit matter might be based on only one factor, a combination of the factors, or other factors specific to the audit” (PCAOB 2016, Page 25). The principles-based framework does not allow for a matter that, if present, would always constitute a critical audit matter. The PCAOB has effectively left it to the auditor’s judgment to determine what a critical audit matter is, how to disclose the critical audit matter, and how the disclosed critical audit matter was addressed in the audit engagement with related audit procedures. These significant regulatory changes have spurred academic interest in how the revisions to the standard audit report are received by varying classes of stakeholders.

2.3 Accounting Literature

Academics have investigated the effect of changes to the auditor’s report in international jurisdictions where critical or key audit matter (KAM) disclosures have been mandated by statute or regulation. In 2013, standards became effective in the U.K. that required the audit committee report to identify significant financial statement issues and the discussion surrounding these

issues¹¹ (Reid et al. 2015). The regulation’s revisions go on, requiring the auditor to discuss in the auditor’s report their assessed risk of material misstatement and the materiality threshold that was used by the auditor in the current engagement (Reid et al. 2015). Specifically, the auditor is required to disclose the risks that “had the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team” (FRC 2013, 6).

2.3.1 International Archival Evidence

The standards promulgated by the FRC and IAASB share some similarities with the PCAOB’s re-proposed rule. Key Audit Matters (KAMs) are similar to the PCAOB’s CAMS in that they are described as areas that are highly subjective and involve significant accounting estimates. Both sets of standards require the auditor to disclose the area or account and how the matter was addressed in the audit using a principles-based framework. The FRC and IAASB standards diverge from the PCAOB in stating the level of materiality for the engagement and how the auditor arrived at their stated level of materiality for the client firm. Further, the areas disclosed as KAMs are identified as those with the highest risk of material misstatement, language not mandated by the PCAOB. Finally, the FRC requires that the auditor disclose their conclusion on the KAM account to the audit committee based on the results of their procedures. While both standards involve a principles-based framework in meeting the regulatory

¹¹ A brief review of the Independent Auditor’s Report for U.K. Fortune 40 firms revealed the following issues listed as key audit matters: rebates, chargebacks, and returns (AstraZeneca 2016), valuation of intangible assets (AstraZeneca 2016), litigation and contingent liabilities (AstraZeneca 2016, BP 2016, RBS 2016), carrying value of assets (BP 2016), revenue recognition (Vodafone 2015, Carnival 2016, Glencore 2016), management override and earnings management (Glencore 2016), recoverability of aged and overdue receivables, loans, and advance payments (Glencore 2016), impairment of loans and advances (HSBC 2015, RBS 2016), and estimates of future profitability (RBS 2016).

requirements, the language and disclosures required by U.K. auditors are more focused on the risk of material misstatement, potentially due to differences in the legal environment between the U.S. and U.K.

Researchers were quick to investigate what effect, if any, the expanded audit report would have on levels of audit quality, financial reporting quality, and audit fees. The revised regulatory environment created by the FRC rule resulted in a significant decrease in abnormal accruals and the propensity to meet or beat analyst forecasts (Reid et al. 2015) in the year following adoption in the U.K. In a separate study, Lennox et al. (2015) find that the valuation coefficients following the year of adoption in the U.K. were not significantly different from those for the year prior to adoption, suggesting that the enhanced disclosures are not informative to investors. Lennox et al. (2015) conclude that disclosing critical audit matters may not aid investors in distinguishing between more and less risky companies because investors are already equipped to identify those firms that were more risky and those firm that were less risky. Gutierrez et al. (2016) investigate the impact of changes to the audit report in the United Kingdom and report conflicting evidence in their results. They find that audit fees change variably (increase of 4% to no change depending on the model used) but do not find any evidence of change to audit quality nor any public reaction to the new auditor's report. The conflicting results from an archival perspective provide motivation to determine what effect, if any, CAM disclosures and the audit procedures engaged to address them in the audit report have on nonprofessional investors' confidence in the audit report and financial statements in a controlled experimental setting.

2.3.2 *Experimental Evidence*

The majority of experimental research conducted with respect to CAMs has been done in a litigation setting to determine the incremental effect of CAM disclosure on jurors' perception of auditor liability¹². Backof et al. (2015) find that an inclusion of the specific audit procedures conducted to address the CAM in the audit report results in a higher likelihood that the auditor is found negligent by a jury, but that this effect is mitigated when the term "reasonable assurance" is defined within the audit report. In contrast, a working paper by Brown et al. (2014) provides evidence consistent with the story model¹³ that suggests the inclusion of CAMs in the auditor's report will decrease the evaluation of negligence on the part of the auditor; however, in the presence of CAMs, when the auditor is determined to have acted negligently, proposed damages are more severe. This result suggests that audit quality is perceived to be higher in the presence of a CAM disclosure than in the absence of a CAM disclosure.

A different stream of research has investigated how users of financial statements and the auditor's report will receive the revisions to the standard auditor's report. A working paper by Sirois et al. (2014) shows that the inclusion of a CAM in the audit report is successful in motivating users to allocate additional cognitive resources to the issues mentioned in the report; however, the inclusion of a CAM has the drawback of reducing perceived audit quality, inconsistent with the intentions of regulators. A second working paper by Carver and Trinkle

¹² As noted in a working paper by Kachelmeier et al. (2016) a large volume of comment letters to the PCAOB's 2011 concept release and the PCAOB's 2013 proposed rule were concerned with changes to the standard audit report would impact auditor's legal exposure and legal liability (Ernst & Young 2013, KPMG 2013, Tysiac 2013, Zietsman, Burns, Pruitt, and Simer 2013).

¹³ The story model (Pennington and Hastie 1992) suggests that jurors construct narratives in their mind to make sense of the information presented during a trial while reaching their verdicts. In their manuscript, Brown et al. (2014) argue that the inclusion of a CAM disclosure will decrease jurors' assessments of auditor negligence as the judges interpret the information as a story of the auditor's competence by warning the investors that the area disclosed is very complex and subject to error.

(2016) examine how investors perceive the revision to the standard auditor's report and how the changes impact perceptions of auditor credibility and management credibility. The results show that the inclusion of a CAM in the auditor's report does not impact investors' perceptions of auditor credibility, reliability, but can impact management credibility under certain circumstances. Further, the inclusion of a CAM in the auditor's report does not impact valuation assessments, leading Carver and Trinkle (2016) to conclude that the revisions to the report will have little to no impact on investors' judgments.

Other researchers suspect that the format of CAM disclosures could differentially impact investors' judgments. A working paper by Dennis et al. (2016) examines the impact of visual cues in auditor disclosures and how the cues impact nonprofessional investors' interpretation of the information. The authors find that a narrative description of the audit disclosure is not weighted by nonprofessional investors and is used as a substitute for management disclosures in valuation judgments. The authors further find that visual cues in the audit disclosure change how nonprofessional investors weight the audit disclosure and the management disclosure where nonprofessional investors discount P/E multiples to a greater extent in the presence of an auditor visual disclosure relative to an auditor narrative disclosure (Dennis et al. 2016).

Kachelmeier et al. (2016) provide a different perspective on financial statement reliability in the presence of a CAM disclosure. In their experiment, Kachelmeier et al. (2016) find that user confidence in financial statements containing a CAM is lower relative to user confidence after viewing financial statements containing no CAM. Kachelmeier et al. (2016) cite Heymann (2010) and Literary Theory to explain that the disclosure of a CAM may act as a warning that the financial statements need to be interpreted with caution. Literary Theory explains how readers of a message interpret the contents of that message. When a message contains contravening or

unexpected language, the reader of that message adopts a cautionary perspective when reading the remainder of the message and interpreting the information that the message relates to. In the case of CAMs, the contravening language contained within the CAM (e.g. involved especially challenging, subjective, or complex audit judgment) after reading the unqualified opinion offered on the financial statements will motivate users to be more skeptical of the information that the contravening language (CAM) referred to, in this case the financial statements and the CAM account specifically.

The existing literature on critical audit matter disclosures is subject to several limitations. For example, Kachelmeier et al. (2016) does not consider how the freedom given to the auditor by the PCAOB in fulfilling their regulatory obligation will impact nonprofessional investors' confidence in the reliability and accuracy of the reported figures. I differentiate my study by examining how detailed language included in a CAM disclosure may be interpreted differently from generic language in a CAM disclosure by nonprofessional investors. Further, I help to inform policy by following the guidance set out in the PCAOB's May 11, 2016 re-proposed standard that includes mandatory disclosure of how the auditor addressed the CAM in the auditor's report (i.e. audit procedures). Finally, my dependent measures capture both perceptions of financial reporting quality and perceptions of audit quality to determine if the language contained within the CAM disclosure along with the language of the engaged auditing procedures results in a differential effect for perceived financial reporting quality and perceived audit quality (Gaynor et al. 2016).

2.4 Literary Theory and the Disclaimer Effect

The “disclaimer effect”¹⁴ from Literary Theory states that the presence of contravening language in a narrative will serve as an attention director to readers of the narrative that the information they are about to be exposed to should be attended to very carefully. In the present context¹⁵, the disclaimer effect should not be interpreted to suggest that the auditor is offering a disclaimer of opinion on the financial statements, nor or they disclaiming responsibility for the audit. A disclaimer effect simply suggests that the presence of contravening language will capture the reader’s attention so they will fully attend to the disclosed items. However, if the user of the audit report views the CAM as providing additional assurance on the disclosed account and the financial statements, it could reinforce the presence of an unqualified opinion, resulting in higher perceptions of audit quality.

Disclaimers within a narrative or message exist to encourage users of the product or document to which the narrative refers to exercise appropriate care and precaution (Heymann 2010). Further, effective disclaimers are those consisting of language that is unexpected by the reader (Heymann 2010). This statement suggests that the unique presentation of CAMs as

¹⁴ Please note that the “disclaimer effect” as stated in this paper is not synonymous or related to a disclaimer of opinion by the auditor. The auditor is supplying a level of reasonable assurance on the financial statements as a whole. The “disclaimer effect” simply refers to the auditor brining a specific account to the attention of the reader and explaining why is was a subjective and difficult account to audit. However, despite these difficulties, the auditor is satisfied with the representation of the account in the financial statements. The “disclaimer effect” suggests that, when a good or service is highlighted with contravening language (e.g. account characterized by difficult and subjective estimates) the reader will be more skeptical of the good or service and have their underlying confidence in the quality of the good or service adversely impacted. As pointed out by Kachelmeier et al. (2016) the audit report is not a good or service but is the product of the auditor’s efforts and the disclosure of a CAM could amount to a “disclaimer effect”.

¹⁵ A per Literary Theory (Heymann 2010) a disclaimer is defined as any language that suggests a contravening message to the primary message. In the context of the audit report, a “disclaimer effect” would occur when language contained within the audit report is incongruent with the primary message, or opinion, of the audit report. If a CAM disclosure functions as a disclaimer, it will be interpreted as cautioning users in their interpretation of the financial statements, thus negatively impacting the perception of financial reporting quality.

proposed by the PCAOB will promote effortful reading and interpretation by the user of the audit report; whereas the audit report contains standardized language for each engagement, the CAM disclosure will be somewhat unique to each engagement by highlighting the accounting issues identified by the auditor and the tests conducted to address these issues leading to the “disclaimer effect”. Additional results that support the “disclaimer effect” from Literary Theory are found in Christensen et al. (2014) where users’ confidence in the financial statements is negatively impacted by the disclosure of a CAM.

2.5 Support Theory

Support theory (Tversky and Koehler 1994) suggests that a judge will assess the likelihood of an event by evaluating the support for the underlying component hypotheses, defined as the descriptions of the event or the pieces of supporting evidence for the event, rather than by assessing the probability of the event itself. The theory associates a description of the event with a support value that directly corresponds to the perceived strength of the description. By explicitly listing the justification for an event or hypothesis, a judge is able to “unpack” the event into supporting components, making them more confident in the probability of the underlying event.

An easily accessible example of support theory may be found in one of the experiments from Tversky and Koehler (1994). In their experiment, Tversky and Koehler (1994) asked participants to judge the probability of two complementary hypotheses¹⁶: death by natural causes

¹⁶ As described by Doxey (2015), complementary hypotheses are defined as events that are mutually exclusive but together are exhaustive. For example, the probabilities that it does rain or that it does not rain are mutually exclusive and cover all potential outcomes. However, the event “does not rain” may be further unpacked into several component events (e.g. it is overcast, it is sunny, it snows).

or death by unnatural causes. When participants were asked for their probability assessments of the packed hypotheses or events they estimated the probability assessments to be 58 percent and 32 percent respectively (sum of 90 percent) (Tversky and Koehler 1994). However, when the researchers asked participants to unpack death by natural causes into separate supporting hypotheses, such as death due to heart disease, cancer, or any other natural causes their probability assessments significantly increased to 73 percent (22 percent, 18 percent, and 33 percent respectively). The implication that was drawn by Tversky and Koehler (1994) was that for the probability assessment for death by natural causes to hold, the probability assessment for death by unnatural causes would have to be reduced so as not to exceed 100 percent, a phenomena that Tversky and Koehler (1994) termed “subadditivity”.

Support Theory has been shown to be robust in a number of settings with professionals. Brody et al. (2003) demonstrates that experienced decision makers from large international accounting firms more than double their probability assessments of material misstatement when given four pieces of supporting evidence about an audit client versus those who are given one, overarching piece of evidence¹⁷. Auditors who assess fraud risk sequentially by area (e.g. revenue recognition/receivables, inventory, noncurrent assets, and management estimates) rather than simultaneously identify a greater quantity and quality of fraud risk assessments that are more evenly distributed over the areas assessed consistent with the unpacking feature of support theory (Chen et al. 2014); this is due to the increased salience of each category when it is

¹⁷ Brody et al. (2003) ask auditor participants for the probability of misstatement involving the valuation objective. In the packed condition, participants were asked to assign probabilities to the Inventory/Purchases Transaction Cycle, the Sales and Collection Transaction Cycle, and Some Other Transaction Cycle. In the unpacked condition, Some Other Transaction Cycle was presented as four subsets: Investing Cycle, Financing Cycle, Payroll Cycle, or Some Other Transaction Cycle. The results were consistent with the predictions of Support Theory (Tversky and Koehler 1994).

presented separately rather than contemporaneously (Van Boven and Epley 2003). Hammersley et al. (2010) find that auditors who are reminded of eight areas of fraud risk within an organization make higher fraud risk assessments than auditors who are only presented with a summary memo of a fraud risk brainstorming session.

The predictive power of Support Theory has been demonstrated in a managerial realm as well. When forecasts are disaggregated as opposed to aggregated, the forecasts result in greater forecast accuracy (compared to preparing aggregated forecasts) and disaggregated forecasts result in greater forecast optimism or the tendency to overestimate future performance (compared to preparing aggregated forecasts) consistent with the implications of Support Theory (Chen et al. 2015).

Therefore, by detailing the considerations that led the auditor to determine the account was a CAM within the audit report, such as the considerations that are unique and specific to the firm in question, nonprofessional investors will be able to “unpack” the different dimensions of the CAM, such as the uncertainty surrounding estimates, the presence of significant management judgment, and the lack of historical information, leading them to increase their judgments of the uncertainty in the accuracy and reliability of the underlying account. Nonprofessional investors will similarly unpack the separate audit procedures engaged to address the CAM, resulting in lower levels of confidence in the accuracy and reliability of the disclosed account and the quality of the audit.

2.6 Boundary Condition of Support Theory

Support Theory is subject to a boundary condition (Sloman et al. 2004). When the supporting descriptions are more specific to a particular setting or atypical of the event they are

proposed to represent, unpacking results in judgments that the underlying event is less probable; Sloman et al. (2004) attribute this result to individuals unable to generalize the supporting descriptions to other examples of the parent hypothesis in their working memory. Hammersley et al. (2010) demonstrate this phenomenon where auditors that unpack fraud risks assess a lower level of fraud risk when the fraud risks unpacked are unique and specific to the client firm. These unique fraud risks, which are less representative of fraud in general, occupy resources from working memory that could otherwise be used to attend to more likely fraud risks. Therefore, when the pieces of supporting evidence are viewed as atypical or ungeneralizable, unpacking would result in lower assessments in the target event. As nonprofessional investors are unfamiliar with specific financial statement accounts and the risks that give rise to the CAM, any substantial detail in describing the CAM could be seen as atypical, especially if these details are firm specific. Based on the previous discussion and expanding on the findings of Kachelmeier et al. (2016), it would be expected that a detailed disclosure of the factors that led the auditor to disclose the account as a critical audit matter would result in greater confidence in the CAM account than if the auditor gave a generic description of the CAM account if nonprofessional investors' perceive the pieces of supporting evidence to be less generalizable to other firm. If this is not the case, then unpacking will result in lower confidence in a CAM account when the account is disclosed in greater detail relative to generic detail. For my hypotheses, I will utilize the boundary condition prediction from Support Theory as formulated by Sloman et al. (2004) which states that greater supporting evidence will result in higher confidence assessments in the accuracy and reliability of the disclosed account and higher perceptions of audit quality.

3. HYPOTHESES DEVELOPMENT

Support Theory suggests that individuals will assess the probability of an event subjectively depending on the amount of supporting evidence provided to them to evaluate the likelihood of the event (Tversky and Koehler 1994). The PCAOB's re-proposed rule to expand the standard audit report with a principles-based framework for the allows for significant judgment in how the auditor decides to meet their mandate. Specifically, it is left to the audit firm and audit partner's judgment to determine what level of detail or granularity they will disclose the CAMs identified during the financial statement audit and the audit procedures that were engaged to address the CAMs. As seen from KAM disclosures in the U.K., this level of detail can vary significantly.

Based on prior research in psychology and accounting (Tversky and Koehler 1994, Slovic et al. 2004, Kachelmeier et al. 2016) I predict that, and consistent with the boundary condition of Support Theory, nonprofessional investors will have greater confidence in the accuracy and reliability of the CAM account when the CAM is disclosed in greater detail relative to generic detail.

H1: Nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the CAM account is identified with a detailed disclosure in the auditor's report relative to when a CAM account is identified with a generic disclosure.

The PCAOB's re-proposed standard also calls for the auditor to disclose the audit procedures utilized to address the CAM and provide audit evidence supporting the assertions of management in the audit report. The disclosures of audit procedures in other jurisdictions, particularly the Key Audit Matters required by the Financial Reporting Council in the U.K. and Ireland (FRC 2013), give the auditor great latitude with how and in what detail these procedures are disclosed. Indeed, the PCAOB re-proposed standard encourages language that is specific and unique to each engagement but stops short of requiring detailed, specific language (PCAOB 2016). Therefore, it is pertinent to study the effect of audit procedure disclosure on nonprofessional investors' confidence in the audit report and financial statements. Following the unintuitive predictions from Support Theory's boundary condition (Sloman et al. 2004), I posit that nonprofessional investors will be more confident in the accuracy and the reliability of a disclosed CAM account when the audit procedures engaged to address the CAM account are disclosed in greater detail.

H2: Nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the audit procedures engaged to address the CAM are disclosed in greater detail relative to generic detail.

The intuitive predictions from Support Theory (Tversky and Koehler 1994) suggest that increased detail and specificity in the description of the audit procedures will lead to a greater unpacking effect and differentially impact perceptions of audit quality. However, it should be noted that, objectively, assessments of audit quality should remain constant regardless of the description of the audit procedures performed as the PCAOB explicitly prohibits piecemeal assurance. Any audit procedures performed would be to gather sufficient audit evidence to

satisfy the auditor that the risk of an audit error is reduced to the appropriate level. Following Support Theory, I predict that greater detail and specificity used in describing the audit procedures engaged to address the CAM account will influence nonprofessional investors' perceptions of audit quality positively.

H3: Nonprofessional investors will assess audit quality higher when the related audit procedures are described with greater detail in the auditor's report relative to when the related audit procedures are described with generic detail in the auditor's report.

As noted by Gaynor et al. (2016), there is no consistently accepted definition of financial reporting quality. The *Conceptual Framework for Financial Reporting* (FASB 2010) states the purpose of financial reporting is to provide insight into the underlying economic position of the reporting firm. Following the definition adopted by Gaynor et al. (2016), I define greater financial reporting quality as “more complete, neutral, and free from error and provide more useful predictive or confirmatory information about the company's underlying economic position and performance” (Gaynor et al. 2016, 2).

Prior literature in the experimental realm has operationalized financial reporting quality and as the usefulness of the information to the investing party (Clor-Proell et al. 2014, Müller et al. 2015) and directly asked participants to assess financial reporting quality (McDaniel et al. 2002). Further, Gaynor et al. (2016) provide a review of the vast literature which demonstrates how audit quality is a determinant of financial reporting quality. Based on this literature, I propose that nonprofessional investors will assess financial reporting quality higher when the related audit procedures are disclosed in greater detail.

H4: Nonprofessional investors will assess financial reporting quality as higher when the related audit procedures are described in greater detail within the auditor's report relative to when the related audit procedures are described in generic detail within the auditor's report.

As noted above, financial reporting quality has been operationalized in prior literature as information that is free from error, complete, and neutral (Gaynor et al. 2016). Based on the prior literature, I posit that as the relationship between CAM disclosure language and financial reporting quality is mediated by their confidence in the accuracy and reliability of the disclosed CAM account.

H5a: Nonprofessional investors' confidence in the accuracy and reliability of a CAM account will positively mediate the relationship between CAM disclosure detail and assessments of financial reporting quality.

Further, following the large literature on the relationship between audit quality and financial reporting quality, the detail and specificity of the audit procedures performed could influence confidence in the financial statements since increased perceptions of audit quality could increase confidence in the underlying accounts as discussed by DeFond and Zhang (2014). Therefore, I predict that assessments of audit quality will mediate the relationship between the detail with which audit procedures are disclosed and financial reporting quality.

H5b: Nonprofessional investors' assessment of audit quality will positively mediate the relationship between audit procedure disclosure detail and assessed financial reporting quality.

I next propose two hypotheses to explain how my independent variables indirectly impact assessed misstatement probability. As participants grow more confident in the accuracy and reliability of the CAM account, as would be the case when the CAM account is disclosed in greater detail, and that the disclosure is complete and free from error, their assessments of the probability of material misstatement will decrease.

H6a: Nonprofessional investors' confidence in the accuracy and reliability of a CAM account will negatively mediate the relationship between CAM disclosure detail and assessed probability of material misstatement.

Similarly, as participants grow more confident that the auditor provided the correct opinion on the financial statements and that the quality of the audit engagement was high, as would be the case when the auditor procedures are disaggregated and described in greater detail, their assessments of the probability of material misstatement will decrease.

H6b: Nonprofessional investors' assessments of audit quality will negatively mediate the relationship between audit procedures disclosure detail and assessed probability of material misstatement.

As the quality of the information reported in the financial statements decreases, nonprofessional investors will perceive additional risk to using the financial statements, including the risk of material misstatement. As financial reporting quality is assessed to be lower and the financial statements are not complete or otherwise free from error, nonprofessional investors will assess the probability of misstatement to be higher.

H7: Nonprofessional investors' assessments of financial reporting quality will negatively impact their assessed misstatement probability.

Finally, as the quality of the financial statements decreases and the probability of material misstatement is assessed to be higher the investment opportunity will be viewed less positively. For example, Barton and Mercer (2005) provide evidence that analysts reduce their stock valuation when financial reporting quality is perceived to be poor. Therefore, I predict that as assessments of material misstatement probability increase that nonprofessional investors will invest less in the target firm.

H8: Nonprofessional investors' assessment of misstatement probability will negatively impact their decision to invest in the target firm and the magnitude of their investment.

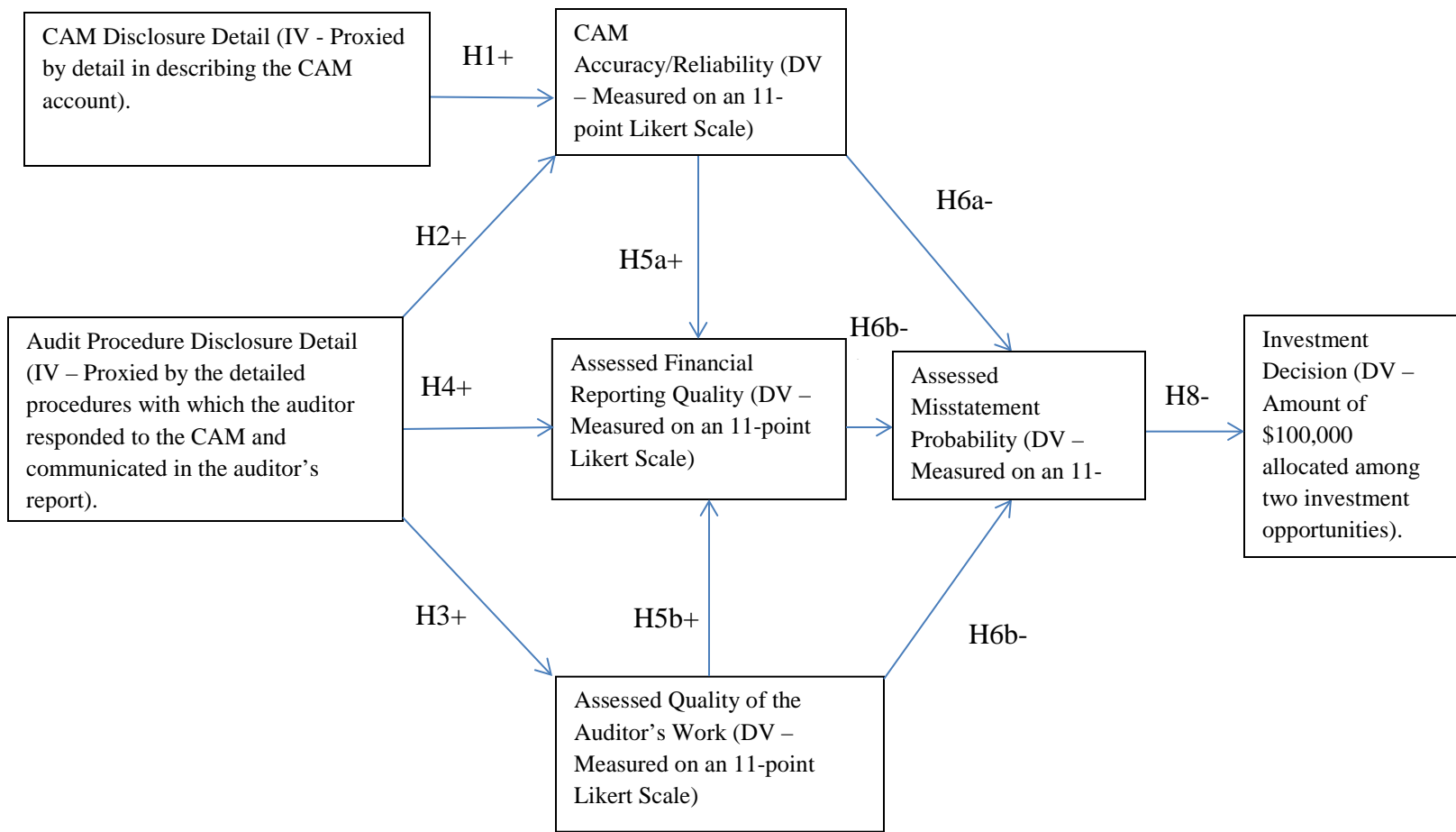


Figure 1: Theoretical Model for Test of Hypotheses and Mediation Analysis

4. METHOD

4.1 Participants

For this research, participants were recruited from Amazon Mechanical Turk. Amazon Mechanical Turk is an online labor marketplace where a requester may post a Human Intelligence Task (HIT) to be viewed by workers. The data collected from participants on Amazon Mechanical Turk are considered to be reliable (Paolacci et al. 2010, Horton et al. 2010, Buhrmester et al. 2011, Farrell et al. 2017, Brasel et al. 2016) and prior research in accounting has successfully recruited participants from Amazon Mechanical Turk to proxy for nonprofessional investors (Rennekamp 2012, Rennekamp et al. 2015, Brasel et al. 2016).

Workers recruited from Amazon Mechanical Turk review the HIT to determine if they are interested in the study, attain any necessary qualifications, and then participate in the experimental case. Upon completion of the study workers are directed back to Amazon Mechanical Turk where they enter a code acquired at the conclusion of the study to receive their compensation¹⁸. Amazon Mechanical Turk has been successfully used in the past to recruit participants as a proxy for nonprofessional investors (Rennekamp 2012, Cade 2016) and participants recruited from Amazon Mechanical Turk have been shown to exert similar levels of effort and honesty as participants in prior research (Farrell et al. 2017).

¹⁸ Prior research indicates that the average hourly wage of Mechanical Turk participants is \$1.38 (Horton and Chilton 2010). The effective hourly wage of participants for my task was \$5.37 far surpassing the average wage of other Amazon Mechanical Turk workers on the platform.

Participant demographics are reported in Table One. They report a mean (median) of 4.69 (2.00) accounting classes. Participants also provide the approximate value of their equity holdings as of December 31, 2016, (two months prior to the experiment) by selecting zero or a range of values inclusive from \$1 to over \$100,000. Ranges were provided for participants to ensure a degree of confidentiality if participants were anxious about disclosing the exact value of equity holdings. Using the lower bound of each response range (Doxey 2015), participants have an average of \$21,155.06 in equity holdings. Using the midpoint of each response range, participants have an average of \$37,020.03 in equity holdings. These demographic results suggest that my sample consists of equity investors who manage their own small portfolios.

I next test for mean differences between conditions with my demographic variables, equity holdings, number of accounting classes, number of financial statement reviewed each month, number of stock transactions engaged in a year, self-assessed familiar with financial statement audits, and full-time work experience. Of these variables, only accounting courses is significant at the $\alpha=.05$ level ($p=.034$). This variable is not used as a covariate in ANCOVA analysis to capture variance that would otherwise be erroneously attributed to the independent variables since the CV does not have a significant effect on the dependent measure of interest when included in the ANCOVA.

The populations described above were used as a proxy for nonprofessional investors in a $2 \times 2 + 1$ (control) between-participants experimental design manipulating CAM disclosure detail and related audit procedure disclosure detail.

TABLE 1
Descriptive Statistics of Sample (n=91)

Treatment conditions (CAM Disclosure Detail/Audit Procedures Detail)

Variables	DETAILED/ DETAILED n = 22		DETAILED / GENERIC n = 18		GENERIC / DETAILED n = 18		GENERIC/ GENERIC n = 18		CONTROL n = 18	
	Mean	Std. Dev	Mean	Std. Dev	Mean	Std. Dev	Mean	Std. Dev	Mean	Std. Dev
Equity Holdings	4.45	1.53	4.88	1.58	3.76	1.39	4.43	1.47	3.36	1.28
F/S Month	1.95	2.26	2.06	3.67	3.06	6.58	1.52	2.16	4.86	8.08
Accounting Classes	3.77	4.98	4.29	4.82	7.59	6.62	4.19	4.63	3.86	5.48
Stocks	15.91	19.71	24.94	34.10	32.12	58.78	20.52	23.78	22.21	23.70
Familiarity with Audits	5.14	1.32	4.24	1.86	5.29	1.10	4.76	1.26	4.07	1.44
Work Experience	14.73	10.56	14.88	12.38	10.47	8.48	16.62	12.50	8.79	5.58
Gender:	Number Percentage		Number Percentage		Number Percentage		Number Percentage		Number Percentage	
Male	15	68%	11	65%	13	76%	12	57%	9	64%
Female	7	32%	6	35%	4	24%	9	43%	5	36%

Definition of Variables

- Equity Holdings** Approximate value of participants' equity holding as of December 31, 2016 (1=\$0, 2=\$1-\$10,000, 3=\$10,001-\$20,000, 4=\$20,001-\$50,000, 5=\$50,001-\$100,000, 6=\$100,001 or more.
- F/S Month** How many public company financial statements are read a month.
- Accounting Classes** How many accounting classes were taken at the college level.
- Stocks** Number of stock transaction engaged in annually.
- Familiarity with Audits** Familiarity with financial statement audits of publicly traded companies.
- Work Experience** Year of full-time professional work experience.

A two-way MANOVA revealed significant differences between conditions with Equity Holdings (p=.034). All other variables were insignificant (p>.10).

4.2 Experimental Procedures

A 2 x 2 + 1 (control) between-participants experiment was conducted with CAM disclosure detail and audit procedure detail as the manipulated independent variables. The experiment was administered online through Qualtrics, a web-based survey platform. My first independent variable, CAM disclosure detail, was manipulated at two levels (Detailed / Generic). My second independent variable, audit procedure detail, was manipulated at two levels (Detailed / Generic). It is important to note that both levels of the manipulation contain all four of the mandatory disclosures detailed in the PCAOB's 2016 re-proposed rule and no condition contains any information that would be explicitly prohibited by the release and indeed may be encouraged by the PCAOB (see PCAOB 2016 for a discussion). It is important to point out that my experimental design is only manipulating one construct, specificity, in two different ways. My two experimental manipulations affect specificity in two areas of the audit report: CAM disclosure and audit procedure disclosure.

To operationalize my independent variables, I reviewed the language and examples included in the PCAOB's 2016 re-proposed rule¹⁹. Further, I reviewed a selection of audit reports of several financial service firms filing in the U.K. who are required to comply with the FRC's KAM disclosure. I identified those KAMs that were most often disclosed by the auditor and reviewed the language included in the KAM disclosure. Further, I reviewed how the auditor gained assurance on the KAM account (synonymous to the PCAOB's related audit procedure requirement) to understand which audit procedures would most likely be disclosed for the CAM

¹⁹ Prior experimental research on CAMs (e.g. Kachelmeier et al. 2016, Carver and Trinkle 2016) use the PCAOB's 2013 guidance to develop their experimental manipulations. I follow and expand on this methodology by following the PCAOB's updated and revised 2016 guidance as well as reviewing actual KAM disclosures for financial service firms in the U.K.

I had chosen. The language and detail of the disclosures in the U.K. regulatory environment were used as a model for my own experimental manipulations while retaining the requirements of the PCAOB's 2016 release.

The first independent variable, CAM disclosure detail, was operationalized as the pieces of supporting evidence that led the auditor to identify the account in question as a CAM. In the Generic Disclosure manipulation, the audit report disclosed that the account was a CAM due to the auditor's complex and subjective judgment in evaluating management's estimates. The Detailed Disclosure manipulation expanded on this explanation by identifying specific areas where the auditor was required to use their complex and subjective judgment in evaluating management's estimates: the historical loss data for the new loan program, the qualitative adjustments to the model for estimating the provision for credit losses (CAM account), and the sensitivity of the historical loss model to subjective estimates.

The second independent variable, audit procedure disclose detail, was operationalized as the number of specific tests identified by the auditor to achieve their audit objective. Previous studies have failed to identify a significant effect of audit procedure disclosure in the audit report on users' perceptions; however, these studies have focused on the mere presence of the audit procedures in the auditor's report and have not examined the features of disclosing the procedures that may impact nonprofessional investors' judgments. Following the methodology above, I reviewed several audit reports and KAMs from the U.K. and listed those procedures that were observed multiple times in distinct reports. I adopted the language contained within these audit procedure disclosures for use in my audit procedure disclosure manipulation following the examples from the PCAOB's 2016 re-proposed rule.

In the Generic Audit Procedure Disclosure condition, the audit report disclosed that the auditor: tested the design and controls over the Company's new models, compared management's assumptions for impairment to externally available data, and performed detailed testing on a sample of the models for unidentified impairment. The Detailed Audit Procedure Disclosure condition expanded on these disclosures by identifying three specific subsets of audit tests performed for each audit program. The complete audit report with manipulated conditions may be found in Figure 2. Full experimental materials are available in Appendix A.

Participants were presented a case where they were asked to assume the role of a nonprofessional investor and evaluate a pair of fictitious firms operating in the financial services industry as an investment prospect utilizing the summary financial information, notes to the financial statements, and the auditor's report presented in the case. Both of the fictitious firms in the experimental instrument belonged to the financial services industry as a conscious design choice. While participants are intimately familiar with everyday financial institutions and the service offerings that concern individual consumers, the population of interest is not suspected to be familiar with the large array of commercial services financial institutions provide. Gaynor et al. (2016) state that complexity and subjectivity in the financial reporting function will create a more difficult auditing environment; therefore, if a CAM disclosure in conjunction with the disclosure of audit procedures has any effect on confidence judgments, this effect should be amplified in this industry and setting.

The critical audit matter communicated below is a matter arising from the current period audit that was communicated or required to be communicated to the audit committee and that: **(1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments.** Critical audit matters do not alter in any way our opinion on the financial statements, taken as a whole, and we do not provide separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Provision for Credit Losses - New Loan Product

As more fully described in Notes 1 and 7 to the financial statements, during 2015, Aubrek Banking began actively marketing a nine-year collateralized loan obligation instrument in addition to the three- and five-year collateralized loan obligation instruments historically marketed. At December 31, 2015, the nine-year loans represented approximately 25% of the collateralized loan obligation instrument portfolio. The provision for credit losses is estimated by management through the application of judgment and the use of highly subjective assumptions.

We determined that the provision for credit losses is a critical audit matter due, in part, to the involvement of our complex and subjective judgments in evaluating management's estimates and the significance of their judgments.

[Specifically, these estimates and judgments included such items as the limited historical loss data for the new loan program, the qualitative adjustments to the model for estimating the provision for credit losses, and the sensitivity of the historical loss model to subjective estimates, among others.]

Auditor's Response to the Critical Audit Matter

We planned and performed several procedures related to the provision for credit losses for the nine-year loans in connection with forming our overall opinion on the financial statements.

These procedures included, among other procedures, testing the design and operating effectiveness of key controls over the Company's new model, *[including the test of controls over the impairment calculation models including data inputs, controls over collateral valuation estimates, and governance controls including attending key meetings that form part of the approval process for loan impairment provisions].*

We compared management's assumptions for both collective and individual impairment allowances to externally available data, *[including a critical assessment of management's revisions to estimates and assumptions, specifically in respect of the inputs to the impairment models in the commercial and global banking portfolios and the consistency of judgment applied in the use of the economic factors, loss emergence periods, and the observation period for historical default rates].*

Finally, we performed detailed testing on a sample of new and existing models used to calculate both unidentified and identified impairment, *[including testing of the coding used in the impairment models, re-performance of the calculation, testing the extraction of data used in the models, and testing and applying sensitivities to the underlying critical assumptions].*

Figure 2: Audit Report with Experimental Treatments²⁰

²⁰ The italicized, underlined font is only seen when CAM disclosure detail is Detailed in the Provision for Credit Losses section and related audit procedure detail is Detailed in the Auditors Response to the CAM section.

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	Detailed / Detailed	Generic / Detailed
	Generic	Detailed / Generic	Generic / Generic

Figure 3: Experimental Design²¹

To exploit the financial services setting where both of the fictitious firms operate, a critical audit matter detailing the provision for credit losses was included across all conditions for both firms. The CAM discussed that a new series of collateralized loan obligations had been developed by the fictitious company and that the company’s policy for recognizing credit losses²² had been extended, creating a large degree of uncertainty when estimating the provision for credit losses for the year under audit. Further, a relatively small increase in the provision for credit losses year-over-year could be seen in the comparative financial statements. This mild increase to the provision for credit losses account in conjunction with the large increase in

²¹ For the Control Condition, there was no CAM disclosure and therefore, no related audit procedures.

²² A review of key audit matters currently issued in the U.K. reporting regime determined that loan impairment provisions and provision for credit losses were common accounts listed for financial institutions (e.g. Royal Bank of Scotland 2016, HSBC 2016, Standard Chartered Bank 2015).

noninterest income from selling these instruments was another conscious design choice intended to arouse skepticism in the financial statements. The PCAOB explicitly mentions revenue recognition issues, such as allowance for doubtful accounts or a credit loss provision, as an area in which CAMs will likely be employed in future audit reports (PCAOB 2013, 2016); the wording for the CAM was likewise adopted from the PCAOB's 2016 example concerning revenue recognition.

Participants were informed that both of the firms they were reviewing operated in the financial services industry and were publicly traded on the NASDAQ exchange. Participants were informed that management was compensated for meeting or beating analyst benchmarks and were given the benchmark set for the year for both firms (\$1.42 for each). Summary financial statements were then presented to participants indicating that both firms had reported earnings per share of \$1.45 for the year under audit, beating analyst expectations. Following the presentation of the summary financial statements, participants were asked to assess the likelihood that a material misstatement existed for each firm that they (the participant) would consider important and the likelihood that a material misstatement existed for each firm that others would consider important. Finally, participants were asked to make an investment decision and allocate \$100,000 among the two firms.

After reviewing the summary financial information and making their initial investment decision, participants were made aware of the identity of the audit firm for both firms. Both firms were audited by a separate "Big Four" auditor²³. Participants were also informed about the

²³ The auditor for each firm was distinct to avoid any spillover effects that may have been present in an experimental setting where both firms have the same external auditor. Further, each Big Four auditor was assigned a fictitious name to control for any prior reputation that participants may have assigned to a specific firm.

PCAOB's critical audit matter standard and how CAMs and the audit procedures engaged to address the CAMs were now required to be disclosed in the audit report. Included in the description of the new standard is a statement that the disclosure of a CAM did not in any way alter the auditor's opinion on the financial statements as a whole nor provide separate levels of assurance for different accounts. Participants then proceeded to the next page where they found the auditor's report for both firms which contained my manipulations and the notes to the financial statements where the critical audit matter is disclosed.

The audit reports indicated that each firm was given an unqualified opinion by their respective external auditor and that each firm had a single critical audit matter related to the provision for credit losses. The CAM disclosure and the auditor's response to the CAM for Aubrek Banking were randomly selected from one of my four experimental treatments. The CAM disclosure and the auditor's response to the CAM for Bedous Banking were always stated in the Generic CAM disclosure detail / Generic related audit procedure detail condition for comparative purposes²⁴. Participants viewed the audit reports within the online distribution platform and were also instructed to navigate to hyperlinks that would open the summary financial statements, notes to the financial statements, and the audit reports unique to their condition in separate windows for ease of access while answering the case questions²⁵.

²⁴ I determined for Bedous Banking to have a disclosed CAM in the same area as Aubrek Banking due to the PCAOB's position that almost all audit reports will contain one or more CAMs; therefore, it was determined from a comparative standpoint that it would be more informative to compare two firms disclosing a CAM and for Bedous Banking CAM disclosure detail to remain constant in the Generic CAM Generic Audit Procedure condition reflective of the disclosure that would meet the minimum PCAOB standard. Further, anecdotal evidence from the U.K. suggests that firms operating in the same industry will have critical audit matter disclosures in similar accounts, providing external validity to the experimental setting.

²⁵ Participants were allowed access to the summary financial statements, notes to the financial statements, and the auditor's reports for both firms for the entirety of the case. Once the case was completed, a screen appeared informing participants to close all tabs to the financial statements, notes to the financial statements, and the auditor's

Following recent research by Gaynor et al. (2016) which suggests that financial reporting quality and audit quality are separate, yet related, constructs, I use several measures of perceived financial reporting quality and perceived audit quality to investigate how these proposed disclosures could impact each construct separately and utilize confirmatory factor analysis to confirm that factors are loading on the appropriate latent constructs (discussed in Section V. RESULTS). After being exposed to the CAM and audit procedures manipulation contained within the audit report and opening up new windows displaying the summary financial statements, notes to the financial statements, and auditor's reports for ease of access, participants were asked several questions²⁶ with respect to the CAM account (provision for credit losses) and the non-CAM account (goodwill impairment²⁷); these questions included: confidence in the reliability of the account, confidence in the accuracy of the account, and confidence that the account is free from bias (all measured on 7-point Likert scales with labels at 1=Very Unconfident, 4=Neither Confident nor Unconfident, and 7=Very Confident). These confidence assessments were hypothesized to load on the construct CAM_ACCURACY_RELIABILITY in my process model.

reports for both firms before proceeding to the post experimental questionnaire and manipulation check. Participants were required to positively affirm their compliance with the instructions before being allowed to proceed to the manipulation checks and PEQ.

²⁶ To control for potential order effects, all questions hypothesized to load on the latent constructs of CAM_ACCURACY, AUDIT_QUALITY, and FINANCIAL_REPORTING_QUALITY were randomized within their block. Attention check questions were also placed within the block containing the case questions. Randomization of all case questions was chosen to provide additional validity to the factor loadings on the latent constructs with confirmatory factor analysis.

²⁷ Goodwill impairment was selected as a nonCAM account for evaluation due to the account often involving significant management judgment and testing before a final figure is determined. Further, goodwill impairment has the high potential of being disclosed as a CAM accounting in and of itself as stated by the PCAOB (2016) and seen in key audit matter disclosures of U.K. firms.

Participants also answered several questions hypothesized to load on AUDIT_QUALITY²⁸ in my process model, including: agreement that the auditor did a high quality job identifying the CAM, assessment of how well the auditor's work would allow them to accurately identify a CAM, how independent the auditor was with respect to the firm's management, how much effort the auditor performed with their audit procedures to address the CAM, how appropriate the auditor was in their response to address the CAM, their agreement that the auditor did a high quality job planning and performing the audit procedures that address the CAM, the overall competence of the auditor and their work, and the overall quality of the auditor's work (all measured on 7-point Likert scales). Additional measures of audit quality were captured on 7-point Likert scales (labels at 1=Completely Disagree, 4=Somewhat Agree, and 7=Completely Agree) including: agreement that the auditors on the engagement were competent, agreement that the audit engagement as a whole was of high quality, agreement with the auditor to give a clean audit opinion on the financial statements, and agreement that other auditors would have given the same opinion on the financial statements.

For the hypothesized latent construct of FINANCIAL_REPORTING_QUALITY several questions were asked on a 7-point Likert scale (labels at 1=Strongly Disagree, 4=Neither Agree nor Disagree, and 7=Strongly Agree) including: agreement that the company's financial statements accurately represent their performance, agreement that the company's financial statements are reliable, agreement that the company's financial statements are biased, and agreement that the company's financial statements are a good indicator of future performance.

²⁸ Following Doxey (2015), each question hypothesized to load on the latent construct AUDIT_QUALITY was asked with respect to both auditors (Auldley Hoffman, LLP and Darbron Hank, LLP) simultaneously to minimize the presence of any order effect.

Additional questions were asked on a 101-point Likert scale (e.g. labels at 0=Very Objective, 50=Neither Subjective nor Objective and 100=Very Objective), including: how subjective the values reported for the financial statements are as a whole, how uncertain the values reported for the financial statements are as a whole, and how biased the values reported for the financial statements are as a whole.

Participants also responded to questions asking them to assess the likelihood that there was a material misstatement in the provision for credit losses account, the goodwill impairment account, and anywhere in the financial statements (all on 101-point Likert scales with labels at 0=0%, 50=50% and 100=100%). These measures served as a dependent variable of interest in my path analysis.

Following the case questions, participants were informed that they had \$100,000 to invest. The total sum of \$100,000 could be invested in Aubrek Banking (manipulated audit report) Bedous Banking (control audit report) or any combination of the two firms. Participants were then asked how useful the audit report was for making their investment decision (7-point Likert scale with labels at 1=Totally Useless, 4=Neither Useful nor Useless, and 7=Very Useful), how difficult it was to understand the company's financial statements, how difficult it was to understand the contents of the audit reports, how difficult it was to compare the financial statements between the two firms, and how difficult it was to compare the audit reports between the two firms (all on 7-point Likert scales with labels at 1=Very Difficult, 4=Neither Difficult nor Easy, and 7=Very Easy).

4.3 Manipulation Checks

Participants then proceed to the manipulation check and post experiment questionnaire. Participants were explicitly instructed to close all tabs (financial statements, notes to the financial statements, and the auditor's report) that had been opened during the case before proceeding to the manipulation check and were informed that failure to do so may result in forfeiture of compensation²⁹. A question requiring an affirmative response that the participant had closed all tabs was included to further ensure compliance.

Following affirmation that all windows that had been opened during the experiment had been closed, participants were asked several questions to assess their retention of the case materials, including: if the auditor identified a CAM for Aubrek Banking (dichotomous question with choices Yes/No), if the auditor identified a CAM for Bedous Banking (dichotomous question with choices Yes/No), the opinion Aubrek Banking received from the auditor (trichotomous question with choices Unqualified/Qualified/Adverse), the opinion that Bedous Banking received from the auditor (trichotomous question with choices Unqualified/Qualified/Adverse), the account identified as a CAM for Aubrek Banking (Goodwill Impairment, Provision for Credit losses, Depreciation Expense, or None of the Above), and the account identified as a CAM for Bedous Banking (Goodwill impairment, Provision for credit losses, depreciation expense, or none of the above). Questions to assess the effectiveness of the manipulations included the following (all on 7-point Likert scales with labels at 1=Very Low Level of Detail, 4=Neither a Low nor High Level of Detail, and 7=Very High Level of Detail):

²⁹ No participant was denied compensation for failing to close the tabs. The presence of negative consequences was chosen to increase compliance with the instructions before proceeding to the manipulation check and to increase the validity of the results of the manipulation check. However, I cannot say with certainty that participants followed the instructions to close all tabs nor can I identify those participants who failed to comply.

the level of detail used to describe the critical audit matter disclosure in the independent auditor's report of Aubrek Banking, the level of detail used to describe the critical audit matter disclosure in the independent auditor's report of Bedous Banking, the level of detail used to describe the audit procedures performed to respond to and address the disclosed CAM in the independent auditor's report of Aubrek Banking, and the level of detail used to describe the audit procedures performed to respond to and address the disclosed CAM in the independent auditor's report of Bedous Banking.

4.4 Post-Experimental Questionnaire

After answering questions to assess attention to the experimental materials and the effectiveness of the manipulations, participants were asked to respond to several questions acting as control variables. To control for the possibility that participants perceived differential levels of information from the financial statements, participants were asked to assess: the difficulty of comparing the financial statements between both firms (7-point Likert scale with labels of 1=Very Difficult, 4=Neither Easy no Difficult, and 7=Very Easy) and the difficulty of understanding the company's financial statements as a whole (7-point Likert scale with labels of 1=Very Difficult, 4=Neither Easy nor Difficult, and 7=Very Easy)³⁰. I further asked participants to assess the usefulness of the audit report for both firms (7-point Likert scale with labels of 1=Totally Useless, 4=Neither Useful or Useless, and 7=Very Useful), the difficulty in understanding the contents of the company's audit report for both firms (7-point Likert scale with labels of 1=Very Difficult, 4=Neither Easy nor Difficult, 7=Very Easy), and the difficulty

³⁰ These measures were adopted from the instrument used in Doxey (2015) to provide evidence that there were no perceived differences in the usefulness or presentation of the financial statements.

of comparing the audit reports of the two firms (7-point Likert scale with labels of 1=Very Difficult, 4=Neither Easy nor Difficult, 7=Very Easy).

To control for any differences in perceived readability, participants responded to three question for both Aubrek Banking and Bedous Banking (7-point Liker scale with labels at 1=Very Difficult, 4=Neither Difficult nor Easy, and 7=Very Easy) that were adapted from Tan et al. (2014): how difficult it felt to read the auditor's report, how difficult it was to understand the auditor's report, how difficult it felt to process the information in the auditor's report. Finally, participants answered demographic questions before viewing a screen informing them that the survey had concluded and thanking them for their participation.

5. RESULTS

5.1 Participant Retention, Attention Tests, and Manipulation Checks

Amazon Mechanical Turk was engaged to recruit nonprofessional investor participants. 191 participants³¹ completed the instrument and were compensated with \$2.50. Participants who completed the entire instrument took on average 27.92 minutes, resulting in an effective hourly wage of \$5.37 for the entire population. Six comprehension and manipulation checks were completed by participants and only participants who correctly answered all six questions were retained for the final analysis. 20 (10.5%) participants incorrectly responded that no CAM account was disclosed by the auditor for Aubrek Banking (9 participants incorrectly responded a CAM was disclosed for Aubrek Banking in the control condition, equivalent to 4.7% of the total sample). Two (11.5%) participants incorrectly responded that no CAM account was disclosed by the auditor for Bedous Banking (three participants incorrectly responded a CAM was disclosed for Aubrek Banking in the control condition, equivalent to 1.6% of the total sample). Forty-seven (24.6%) participants incorrectly identified the audit opinion that Aubrek Banking received and forty-seven (24.6%) participants incorrectly identified the audit opinion that Bedous Banking received. Finally, forty-four (23%) of participants incorrectly identified the account that was disclosed as a CAM for Aubrek Banking and 38 (20%) participants incorrectly identified the account that was disclosed as a CAM for Bedous Banking.

³¹ Hypothesis testing with the full sample does not produce results that are inferentially synonymous with my constrained sample. Therefore, the participants who fail the comprehension and attention check question are excluded from my analysis.

All participants who failed a manipulation or comprehension check were excluded from the final analysis, leaving 91 usable observations for hypotheses testing³².

I tested the effectiveness of my manipulations by a series of one-way ANCOVAs . A one-way ANCOVA with CAM_DETAIL as the manipulated IV, the level of detail in the CAM disclosure for Aubrek Banking as the DV, and the corresponding measure for Bedous Banking as the CV revealed significant differences between the levels of CAM disclosure detail ($F(1,73)=2.617$, $p=.055$, one-tailed, untabulated) suggesting that participants in the detailed condition perceived the CAM disclosure for Aubrek Banking to be more detailed than those participants in the generic condition. Similarly, a one-way ANCOVA with AUDIT_DETAIL as the manipulated IV, the level of detail in the audit procedures disclosure for Aubrek Banking as the DV, and the corresponding measure for Bedous Banking as the CV revealed significant differences between the levels of audit procedure disclosure detail ($F(1,73)=2.522$, $p=.059$, one-tailed, untabulated) suggesting that participants in the detailed condition perceived the audit disclosure to be more detailed for Aubrek Banking relative to those participants in the generic condition.

5.2 Scale Validation

Before I test hypotheses, I confirm that my dependent measures load on the theorized latent constructs. Three items load on the latent construct of CAM_ACCURACY__RELIABILITY_A with a Cronbach's Alpha of .901 indicating excellent internal consistency (Nunnally 1967). Thirteen items load on the latent construct of AUDIT_QUALITY_A with a Cronbach's Alpha of .930 indicating excellent internal consistency

³² Given the conservative restrictions used to limit my sample size, it is very possible that my statistical results suffer from low power. Given this potential limitation, I interpret my results as significant if they reach the $\alpha \leq .10$ level.

(Nunnally 1967). Six items load on the latent construct of FINANCIAL_REPORTING_QUALITY_A with a Cronbach's Alpha of .894 indicating good internal consistency. All my measures have an alpha in excess of .80, suggesting good internal consistency. I therefore conclude that the requisite conditions of reliability are satisfied. Table 2, Panel B presents the means, standard deviations, and unstandardized alpha score for each dependent measure used in a scale item.

To validate the use of my participants in the present setting I first replicate the findings of Kachelmeier et al. (2016) by demonstrating confidence in the reliability of an account disclosed as a CAM is lower than the confidence in the reliability of an account not disclosed as a CAM. Goodwill impairment served as the non-CAM account and the provision for credit losses served as the CAM account across conditions; the only item manipulated was the description of the CAM account, provision for credit losses. A paired means t-test comparing the mean confidence in an account that is not disclosed as a CAM, goodwill impairment, and the mean confidence of the account that is disclosed as a CAM, the provision for credit losses, was conducted to confirm prior empirical results. The results of the test are significant ($M=4.49$ and $M= 4.33$ for non-CAM and CAM account disclosure, respectively, the difference in means of .16 is marginally significant ($t(90)=1.425$, $p<.079$, one-tailed, untabulated). This suggests that the disclosure of an account as a CAM results in a “disclaimer effect” that adversely impacts nonprofessional investors' confidence in the account; this result is consistent with findings of contemporaneous studies (e.g. Kachelmeier et al. 2016, Christensen et al. 2014, Sirois et al. 2014).

TABLE 2 - Validation of Instrument
Panel A: Case Questions Used

CAM Reliability & Accuracy

As an investor, how much confidence do you have in the _____ of the values reported for the firm's provision for credit losses account specifically?

CRA1 Reliability

CRA2 Accuracy

CRA3 How confident are you that the values reported are free from bias?

Assessed Audit Quality

AQ1 How informative was the disclosure in the audit report that identified the CAM?

AQ2 Please indicate your agreement with the following statement: The auditor did a high quality job in identifying the CAM.

AQ3 Please indicate your agreement with the following statement: The auditor's work would allow them to accurately identify the CAM while conducting the audit.

AQ4 How independent do you believe the auditor is with respect to the firm's management?

AQ5 How much effort do you believe the auditor exerted with their audit procedures to address the firm's CAM?

AQ6 How appropriate do you believe the auditor was in their response to address the CAM detailed in the audit report?

AQ7 Please indicate your agreement with the following: The auditor did a high quality job in planning and performing the audit procedures that addressed the CAM.

AQ8 How would you assess the overall competence of the auditor?

AQ9 How would you assess the overall quality of the auditor's work?

AQ10 Please indicate your agreement with the following statement: I believe that the auditor conducted a high quality audit of the firm.

AQ11 Please indicate your agreement with the following statement: I believe that the auditors working at the auditing firm are competent.

AQ12 Please indicate your agreement with the following statement: I agree with the auditor's decision to give the firm's financial statements a clean audit opinion.

AQ13 Please indicate your agreement with the following statement: I believe other auditors would have given the same audit opinion on the firm's financial statements.

Assessed Financial Reporting Quality

As an investor, how much confidence do you have in the _____ of the values reported for the firm's income statement as a whole?

FRQ1 Reliability

FRQ2 Accuracy

FRQ3 How confident are you that the values reported are free from bias?

FRQ4 The company's financial statement as a whole accurately represent their performance.

FRQ5 The company's financial statements as a whole are reliable.

FRQ6 The company's financial statements as a whole are a good indicator of future performance.

TABLE 2 (Continued)						
Panel B						
Scale Item	N	Item Mean	Item S.D.	Min	Max	Standardized Alpha
CRA1	76	4.45	1.509	1	7	0.840
CRA2	76	4.13	1.552	1	7	0.849
CRA3	76	4.22	1.502	1	7	0.885
CAM Reliability & Accuracy						0.901
AQ1	76	5.13	1.482	1	7	0.932
AQ2	76	5.90	1.046	3	7	0.921
AQ3	76	5.72	1.028	3	7	0.924
AQ4	76	5.79	1.247	2	7	0.927
AQ5	76	5.42	1.278	2	7	0.922
AQ6	76	6.00	0.924	3	7	0.921
AQ7	76	5.53	1.125	2	7	0.919
AQ8	76	5.97	0.765	4	7	0.923
AQ9	76	5.61	1.008	3	7	0.921
AQ10	76	5.79	1.050	3	7	0.919
AQ11	76	5.96	0.756	4	7	0.924
AQ12	76	5.16	1.347	1	7	0.934
AQ13	76	5.55	0.985	3	7	0.929
Assessed Audit Quality						0.939
FRQ1	76	5.18	1.092	2	7	0.857
FRQ2	76	5.20	1.059	2	7	0.855
FRQ3	76	4.64	1.39	1	7	0.885
FRQ4	76	5.17	1.112	1	7	0.864
FRQ5	76	5.17	1.088	2	7	0.859
FRQ6	76	4.72	1.302	1	7	0.925
Assessed Financial Reporting Quality						0.904

5.3 Test of Hypotheses

5.3.1 Hypothesis One

Descriptive statistics for all conditions (including control) may be found in Table A1. I test my hypotheses using the manipulated conditions but not the control condition; since the control condition did not have a CAM disclosure in the audit report or related audit procedures

for Aubrek Banking, the firm of interest that contained the manipulation within the audit report, it is nonsensical to include it in a test that examines differences in the level of detail for a CAM disclosure and the related audit procedures.

H1 stated that nonprofessional investors will have greater confidence in an account disclosed as a CAM in greater detail relative to an account disclosed as a CAM in generic detail. To test H1, a two-way MANCOVA was conducted with CAM_DETAIL (coded as 1=Detailed, 2=Generic) and AUDIT_DETAIL (coded as 1=Detailed, 2=Generic) as the independent variables, assessments of CAM reliability and CAM accuracy for Aubrek Banking as the dependent variables of interest, and assessments of CAM reliability and CAM accuracy for Bedous Banking (the unmanipulated firm presented for comparative purposes) as covariates. The MANCOVA (TABLE 3, PANEL D) shows that CAM_DETAIL impacts participants' perceptions of the CAM account's accuracy ($F(1,70)=1.85, p=.089^{33}$) and reliability ($F(1, 70)=2.583, p=.0565$). Reviewing the pattern of means reveals that nonprofessional investors have greater confidence in the reliability of a CAM account that is disclosed in greater detail. This result is consistent with my expectations; the results are follow the predictions of the boundary condition of Support Theory where additional supporting evidence, when disclosed in greater detail, will decrease assessments of the parent hypothesis, in this case that the CAM account in unreliable. This results in an increase in the assessments of account accuracy and reliability, providing support for H1.

³³ Consistent with directional hypotheses, reported p-values are one-tailed unless otherwise noted.

Table A1: Descriptive Statistics for Dependent Variables and Covariates

Mean (Standard Deviation)						
CAM Detail:	Detailed		Generic		Control	Overall
Audit Detail:	Detailed	Generic	Detailed	Generic	Control	Overall
VARIABLES	n=21	n=17	n=17	n=21	n=15	n=76
Dependent Measures						
CAM Accuracy (Aubrek)	3.62 (1.83)	4.00 (1.41)	4.41 (1.50)	4.52 (1.33)	4.64 (1.45)	4.23 (1.54)
CAM Reliability (Aubrek)	3.90 (1.76)	4.53 (1.28)	4.41 (1.50)	4.95 (1.32)	4.64 (1.60)	4.45 (1.52)
Assessed Audit Quality (Aubrek)	5.71 (0.69)	5.62 (0.91)	5.25 (0.97)	5.90 (0.60)	4.60 (1.37)	5.49 (0.99)
Assessed Financial Reporting Quality (Aubrek)	4.78 (1.25)	5.20 (0.81)	4.90 (0.98)	5.26 (0.62)	4.99 (1.23)	5.02 (1.00)
Investment (Aubrek)	56555.86 (13598.23)	49007.12 (10361.08)	48235.94 (8486.66)	51988.57 (11054.51)	63449.79 (31249.20)	53526 (16385)
Covariate Measures						
CAM Accuracy (Bedous)	3.29 (1.62)	4.00 (1.32)	4.47 (1.50)	4.52 (1.36)	4.14 (0.95)	4.09 (1.45)
CAM Reliability (Bedous)	3.7143 (1.62)	4.47 (1.28)	4.47 (1.42)	5.05 (1.32)	4.14 (1.10)	4.40 (1.43)
Assessed Audit Quality (Bedous)	5.41 (0.63)	5.64 (0.84)	5.19 (0.93)	5.93 (0.60)	5.27 (1.16)	5.53 (0.86)
Assessed Financial Reporting Quality (Bedous)	4.70 (1.20)	5.21 (0.80)	4.87 (0.97)	5.24 (0.75)	4.46 (1.18)	4.90 (1.02)
Accounting Classes	3.85 (5.08)	4.29 (4.82)	7.59 (6.62)	4.19 (4.63)	3.86 (5.48)	4.69 (5.37)
Auditor Objectivity	5.86 (0.73)	5.71 (1.10)	5.24 (1.25)	5.86 (1.39)	5.71 (1.20)	5.70 (1.15)
Audit Report Information	4.62 (1.56)	3.47 (1.50)	3.76 (1.48)	4.00 (1.26)	1.57 (1.09)	3.65 (1.69)

Table 3 - MANCOVA Results for CAM Accuracy and Reliability with AUDIT_DETAIL and CAM_DETAIL

Panel A - Cell Means (Standard Deviation) for CAM Accuracy

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	4.39 (.126)	4.04 (.134)
	Generic	4.05 (.137)	4.01 (.124)

Panel B - Cell Means (Standard Deviation) for CAM Reliability

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	4.59 (.104)	4.74 (.111)
	Generic	4.39 (.113)	4.33 (.103)

Panel C - Two-Way MANCOVA Results

	Value	F	Sig.
CAM_RELIABLE_BEDOUS - Wilks' Lambda	.154	190.247	.001
CAM_ACCURATE_BEDOUS - Wilks' Lambda	.232	114.360	.001
CAM - Wilks' Lambda	0.04	1.422	0.248
AUDIT - Wilks' Lambda	0.032	0.416	0.327
CAM*AUDIT	0.024	0.866	0.425

Table 3 (Continued)
Panel D - Two-Way MANCOVA Results

DV: CAM_ACCURACY

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.567	1	0.567	1.85	0.089
AUDIT	0.705	1	0.705	2.302	0.067
CAM*AUDIT	0.463	1	0.463	1.512	0.112
ERROR	21.433	70	0.306		
Total	1478	76			

DV: CAM_RELIABILITY

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.541	1	0.541	2.583	0.0565
AUDIT	0.143	1	0.143	0.681	0.412
CAM*AUDIT	0.017	1	0.017	0.081	0.777
ERROR	14.667	71	0.210		
Total	1674	76			

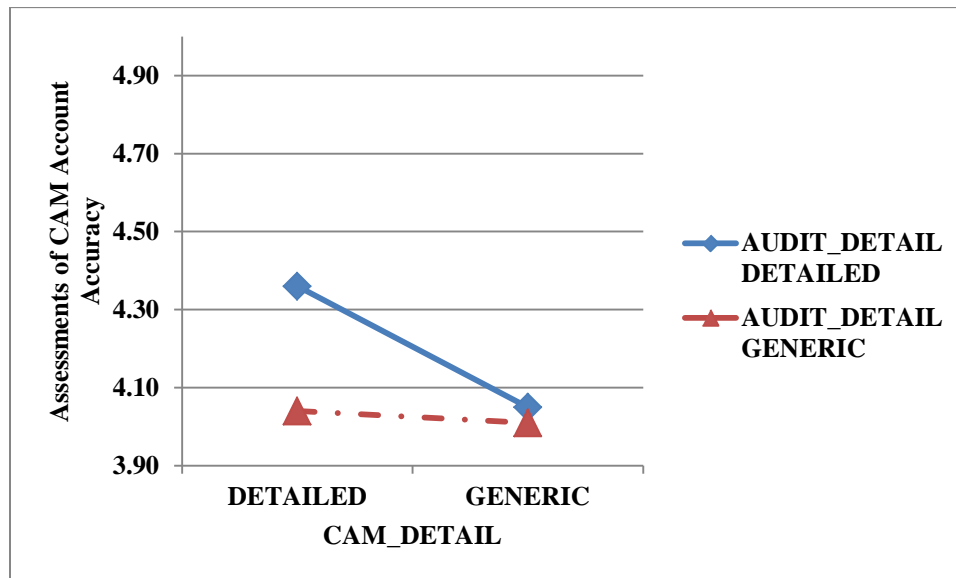


Figure 4: Mean Plots of CAM Account Accuracy

CAM – Level of CAM disclosure detail, coded as 1=Detailed and 0=Generic

AUDIT – Level of related audit procedure disclosure detail, coded as 1=Detailed and 0=Generic

CAM_ACCURACY – Confidence in the accuracy of the disclosed CAM accounting (7-point Likert scale with labels at 1=Very Unconfident, 4=Not Confident nor Unconfident, 7=Very Confident)

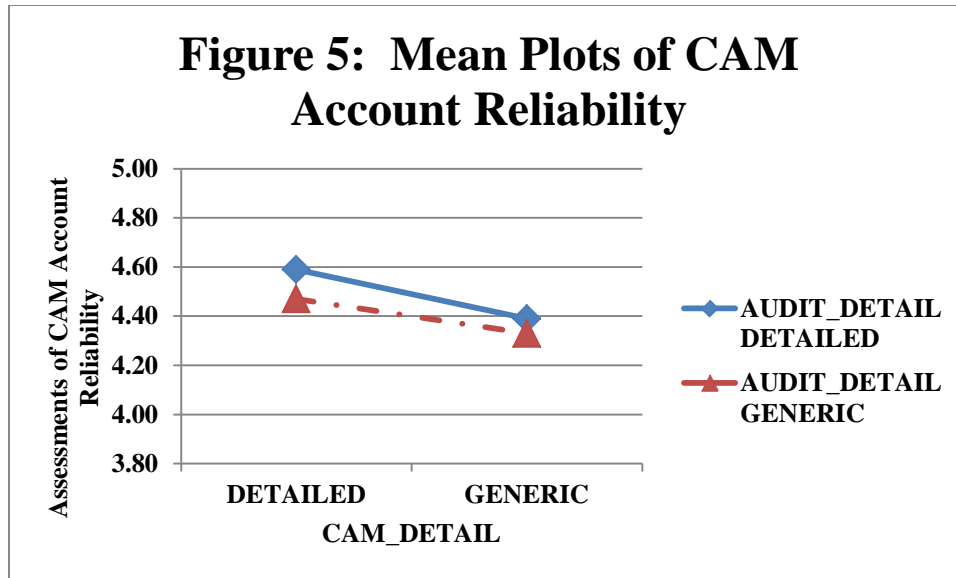


Figure 5: Mean Plots of CAM Account Reliability

CAM – Level of CAM disclosure detail, coded as 1=Detailed and 0=Generic

AUDIT – Level of related audit procedure disclosure detail, coded as 1=Detailed and 0=Generic

CAM_RELIABILITY – Confidence in the reliability of the disclosed CAM accounting (7-point Likert scale with labels at 1=Very Unconfident, 4=Not Confident nor Unconfident, 7=Very Confident)

5.3.2 Hypothesis Two

H2 predicts that nonprofessional investors will be more confident in the accuracy and reliability of an account disclosed as a CAM when the audit procedures engaged to address the CAM are disclosed in more greater detail relative to a CAM disclosed in generic detail. To test H2, I review the results of the MANCOVA conducted in H1.

The results of the MANCOVA are significant for AUDIT_DETAIL when the DV is CAM_ACCURACY ($F(1,70)=2.302, p=.067$) but nonsignificant when the DV is CAM_RELIABILITY ($F(1,70)=.0681, p=.412$). This result (Table 3, Panel D) suggests that nonprofessional investors' have greater confidence in the accuracy of an account disclosed as a CAM when the audit procedures engaged to address the account are disclosed in greater detail relative to a disclosure where the related audit procedures are disclosed in generic detail. Again, this is consistent with my predictions using the boundary condition of Support Theory; the more

supporting specific pieces of evidence the auditor provides for their related audit procedures in the audit report, the greater confidence nonprofessional investors have in the accuracy of that account. The results provide partial support for H2.

5.3.3 Hypothesis Three

H3 predicts that nonprofessional investors will assess audit quality higher when the related audit procedures are disclosed in greater detail relative to when the related audit procedures are disclosed in generic detail. A two-way ANCOVA is used to test H3 with AUDIT_DETAIL and CAM_DETAIL as the independent variables (1=Detailed, 2=Generic) and the average of 13 dependent measures of audit quality for Aubrek Banking as the dependent variable of interest³⁴, and the average of 13 corresponding measures of audit quality for Bedous Banking as a covariate.

Table 4 - ANCOVA Results for Assessed Audit Quality with AUDIT_DETAIL and CAM_DETAIL

Panel A - Cell Means (Standard Deviation) for Assessments of Audit Quality			
		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	5.84 (0.69)	5.54 (0.91)
	Generic	5.58 (0.97)	5.57 (0.60)

³⁴ Confirmatory factor analysis suggests that these 13 dependent measures load on the same latent construct (Cronbach's Alpha=.930) indicating very high internal consistency and suggesting that the factors do indeed load on the same latent construct.

Table 4 (Continued)
Panel B - Two-Way ANCOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.269	1	0.269	1.619	0.1035
AUDIT	0.416	1	0.416	2.503	0.059
CAM*AUDIT	0.369	1	0.369	2.224	0.07
ERROR	11.79	71	0.166		
Total	2467.33	76			

The results of the ANCOVA (Table 4, Panel B) are significant ($F(1, 71)=2.503, p=.059$) suggesting that nonprofessional investors perceive greater levels of audit quality when a CAM is disclosed with more detailed related auditor procedures relative to when a CAM is disclosed with generic related audit procedures. However, this result should be interpreted in light of the significant interaction between CAM*AUDIT ($F(1,71)=2.224, p=.07$) which suggests that CAM disclosure detail interacts with audit disclosure detail to impact assessments of audit quality; specifically, CAM disclosures made with greater detail and audit procedures disclosed in greater detail result in the highest assessments of audit quality. This result is consistent with the predictions Support Theory that states when more pieces of supporting evidence are provided to an individual, that individual will assess the probability of the parent hypothesis higher, therefore resulting in higher perceptions of audit quality. This result provides support for H3.

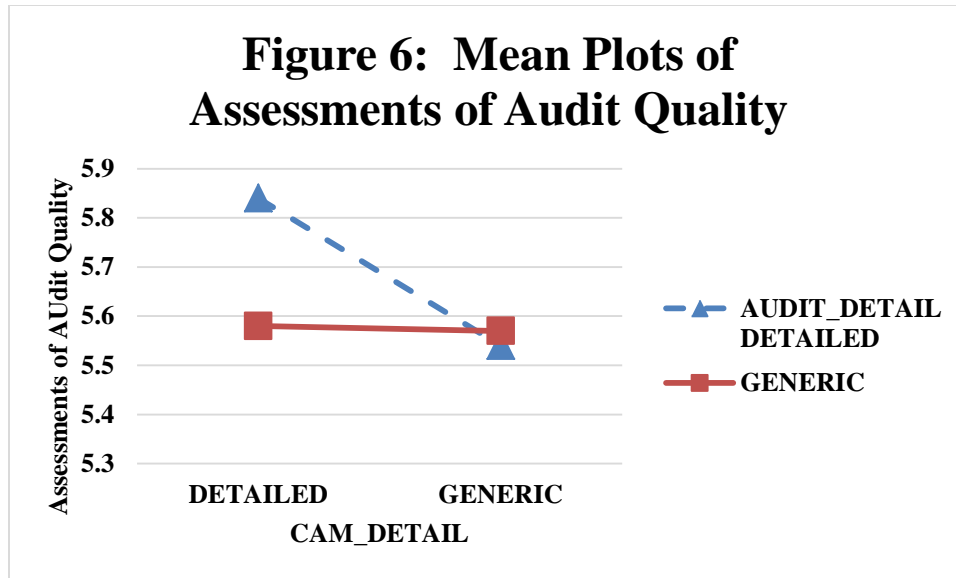


Figure 6: Mean Plots of Assessments of Audit Quality

CAM – Level of CAM disclosure detail, coded as 1=Detailed and 0=Generic

AUDIT – Level of related audit procedure disclosure detail, coded as 1=Detailed and 0=Generic

ASSESSMENTS OF AUDIT QUALITY – The average of 13 dependent measures of audit quality for Aubrek Banking

5.3.4 Hypothesis Four

H4 predicts that nonprofessional investors will assess financial reporting quality probability higher when the related audit procedures are disclosed in greater detail relative to generic detail in the auditor’s report. To test H4, I conduct a two-way ANCOVA with AUDIT_DETAIL and CAM_DETAIL as the independent variables (1=Detailed, 2=Generic). The dependent variable of interest is the average of six dependent measures hypothesized and confirmed to load on the latent construct, assessed financial reporting quality for Aubrek Banking. The corresponding six dependent measures of assessed financial reporting quality for Bedou Banking acts as a covariate

The results of the ANCOVA are not significant ($F(1,71)=0.96, p=.758$) (Table 5, Panel B). These results suggest that nonprofessional investors do not assess financial reporting quality

higher when the audit procedures are disclosed in greater detail and the corresponding assessments for the control firm are accounted for, failing to provide support for H4.

Table 5 - ANCOVA Results for Assessed Financial Reporting Quality with AUDIT_DETAIL and CAM_DETAIL

Panel A - Cell Means (Standard Deviation) for Assessments of Financial Reporting Quality			
		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	4.71 (1.24)	4.90 (0.98)
	Generic	5.20 (0.81)	5.26 (0.62)

Panel B - Two-Way ANCOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.01	1	0.01	0.315	0.577
AUDIT	0.032	1	0.032	0.096	0.758
CAM*AUDIT	0.063	1	0.063	0.628	0.431
ERROR	7.165	71	0.101		
Total	1979.972	76			

5.3.5 Hypothesis 5a

To test Hypothesis 5a, 5b, 6a, 6b, 7, and 8, I develop a structural equation model (SEM). The model fit of the hypothesized model in Figure One is poor ($\chi^2_{(13)}=41.867$, $p<.001$, CFI=0.709, RMSEA=.171) leading me to modify the model. Byrne (2010) states that the chi-square statistic should be insignificant (although a significant chi-square can be overlooked with when other fit statistics are acceptable due to its sensitivity to sample size), CFI should be ≥ 0.9 ,

and RMSEA should be ≤ 0.06 . After reviewing the modification indices, I included three unhypothesized paths: a path from CAM, AUDIT, and CAM*AUDIT to INVEST. This model fits my data well ($\chi^2_{(25)}=124.301$, $p<.001$, CFI=0.991, RMSEA=.031).

Table 6 - Confirmatory Factor Analysis for Perception Factors

Factor	Items	Cronbach's Alpha	
		Raw	Standardized
CAM Reliability/Accuracy	3	0.901	0.901
Assessed Audit Quality	13	0.930	0.939
Assessed Financial Reporting Quality	6	0.894	0.904

Hypothesis 5a states that nonprofessional investors' confidence in the accuracy and reliability of a CAM account will positively mediate the relationship between CAM disclosure language and assessments of financial reporting quality. The path coefficient from CAM to CAM_ACCURACY_RELIABILITY is significant ($\beta=2.339$, $p=.045$), and the path coefficient from CAM_ACCURACY_RELIABILITY to FRQ is significant ($\beta=-2.170$, $p<.001$) suggesting mediation. The path coefficient from CAM to FRQ is not significant ($p=.953$) suggesting full mediation. The total indirect effect of CAM on FRQ is $\beta=-5.08$. While these results are significant, they are in the opposite direction of H5a. Therefore, the results do not provide support for H5a.

5.3.6 Hypothesis 5b

Hypothesis 5b states that nonprofessional investors' assessment of audit quality will positively mediate the relationship between audit procedure disclosure language and assessed financial reporting quality. The path coefficient from AUDIT to AUDIT_QUALITY is marginally significant ($\beta=0.275$, $p=.075$, one-tailed) and the path coefficient from AUDIT_QUALITY to FRQ is significant ($\beta=-1.365$, $p=.033$, one-tailed) suggesting mediation.

The path coefficient from AUDIT to FRQ is not significant ($p=.942$) suggesting full mediation. The total indirect effect of AUDIT on FRQ is $\beta = -0.375$. Again, while these results are significant, they are contradictory to my predictions for H5b. Therefore, the results provide do not provide support for H5b.

5.3.7 Hypothesis 6a and 6b

Hypothesis 6a states that nonprofessional investors' confidence in the accuracy and reliability of a CAM account will negatively mediate the relationship between CAM disclosure language and assessed probability of material misstatement. The path coefficient from CAM to CAM_ACCURACY_RELIABILITY is significant ($\beta=2.339$, $p=.045$, one-tailed). The path coefficient from CAM_ACCURACY_RELIABILITY to MISSTATEMENT is significant ($\beta=-10.324$, $p=.007$, one-tailed) suggesting mediation. The path coefficient from CAM to MISSTATEMENT is insignificant ($p=.979$) suggesting full mediation. The total, indirect effect of CAM on MISSTATEMENT is calculated as $\beta=-24.15$. These results provide support for H6a.

Hypothesis 6b states that nonprofessional investors' assessments of audit quality will negatively mediate the relationship between audit procedures disclosure language and assessed probability of material misstatement. The path coefficient from AUDIT to AUDIT_QUALITY is marginally significant ($\beta=0.275$, $p=.065$, one-tailed). The path coefficient from AUDIT_QUALITY to MISSTATEMENT is marginally significant ($\beta=14.522$, $p=.075$, one-tailed). Finally the path coefficient from AUDIT to MISSTATEMENT is not significant ($p=.736$) suggesting full mediation. Despite marginal levels of significance, these results are in the opposing direction of H6b predictions. Therefore, the results fail to support H6b.

5.3.8 Hypothesis 7 & 8

Hypothesis 7 states that nonprofessional investors' assessments of financial reporting quality will negatively impact their assessed misstatement probability. The path coefficient from FRQ to MISSTATEMENT is significant ($\beta=7.243$, $p=.001$) but is opposite the predicted direction, failing to provide support for H7.

Finally, Hypothesis 8 states that nonprofessional investors' assessment of misstatement probability will negatively impact their decision to invest in the target firm and the magnitude of their investment. The path coefficient from MISSTATE to INVEST is not significant ($p=.635$) failing to provide support for H8.

Interpreted together, the results of the path model suggest that the effect of CAM disclosure detail on assessments of financial reporting quality are fully mediated by confidence in the accuracy and reliability of the CAM account. In turn, the effect of confidence in the accuracy and reliability of the CAM account on assessments of misstatement probability are partially mediated through assessments of financial reporting quality; the full effect of CAM_ACCURACY_RELIABILITY on MISSTATEMENT is negative which suggests that as nonprofessional investors grow more confident in the accuracy and reliability of the CAM account as disclosure detail increase, they assess the likelihood of misstatement to be lower, consistent with the boundary condition of Support Theory. Similar inferences may be drawn from the mediation of AUDIT on FRQ and MISSTATEMENT through AUDIT_QUALITY. Overall, these results are informative in demonstrating how nonprofessional investors arrive at their assessments of financial reporting quality and misstatement. Further, the results show that the effect of CAM disclosure detail and audit procedure disclosure detail are fully mediated through assessments of CAM accuracy/reliability and audit quality respectively. Finally, the

results are consistent with the boundary condition of Support Theory, where CAM disclosures and audit procedures disclosures that are made in greater detail decrease nonprofessional investors' assessments that a material misstatement is present in the financial statements.

Table 7 - SEM Results

Panel A - Selected Path Coefficients				
Link	Path Coefficient	Standard Error	p (one-tailed)	
CAM ---> CAM_A_R	2.339	1.375	0.045	
AUDIT ---> CAM_A_R	1.216	0.840	0.075	
AUDIT ---> AUDIT_QUALITY	0.275	0.182	0.065	
CAM_A_R ---> FRQ	-2.17	0.425	0.001	
CAM_A_R ---> MISSTATEMENT	-10.324	2.133	0.001	
AUDIT_QUALITY ---> FRQ	-1.365	0.742	0.033	
FRQ ---> MISSTATEMENT	1.266	0.458	0.006	
CAM ---> INVESTMENT	-3.103	1.314	0.018	
AUDIT ---> INVESTMENT	-1.891	0.81	0.020	
CAM*AUDIT ---> INVESTMENT	1.134	0.515	0.028	

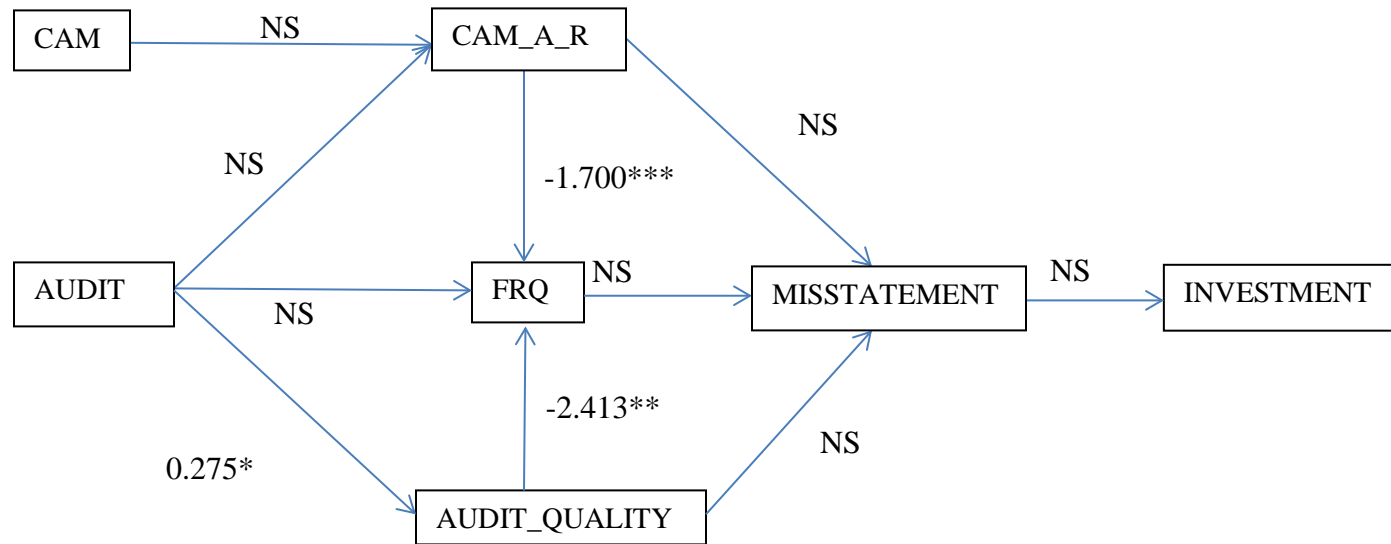


Figure 7: Test of Hypothesized Model³⁵

Variable Definitions:

- CAM** – Level of CAM disclosure detail, coded as 1=Detailed and 0=Generic
- AUDIT** – Level of related audit procedure disclosure detail, coded as 1=Detailed and 0=Generic
- CAM*AUDIT** – Interaction term of CAM and AUDIT
- CAM_A_R** – Assessed confidence in the CAM account’s accuracy and reliability as the average of three dependent measures on 7-point Likert scales
- FRQ** – Assessed financial reporting quality as the average of six dependent measures on 7-point Likert scales
- AUDIT_QUALITY** – Assessed audit quality as the average of 13 dependent measures on 7-point Likert scales
- MISSTATEMENT** – Post manipulation difference measure of assessed likelihood of misstatement anywhere in the financial statements on a 101-point Likert scale
- INVESTMENT** – Post Manipulation difference measure of investment in Aubrek Banking; \$0-\$100,000, inclusive

³⁵ Only parameters reported in the model diagrams are path coefficients.

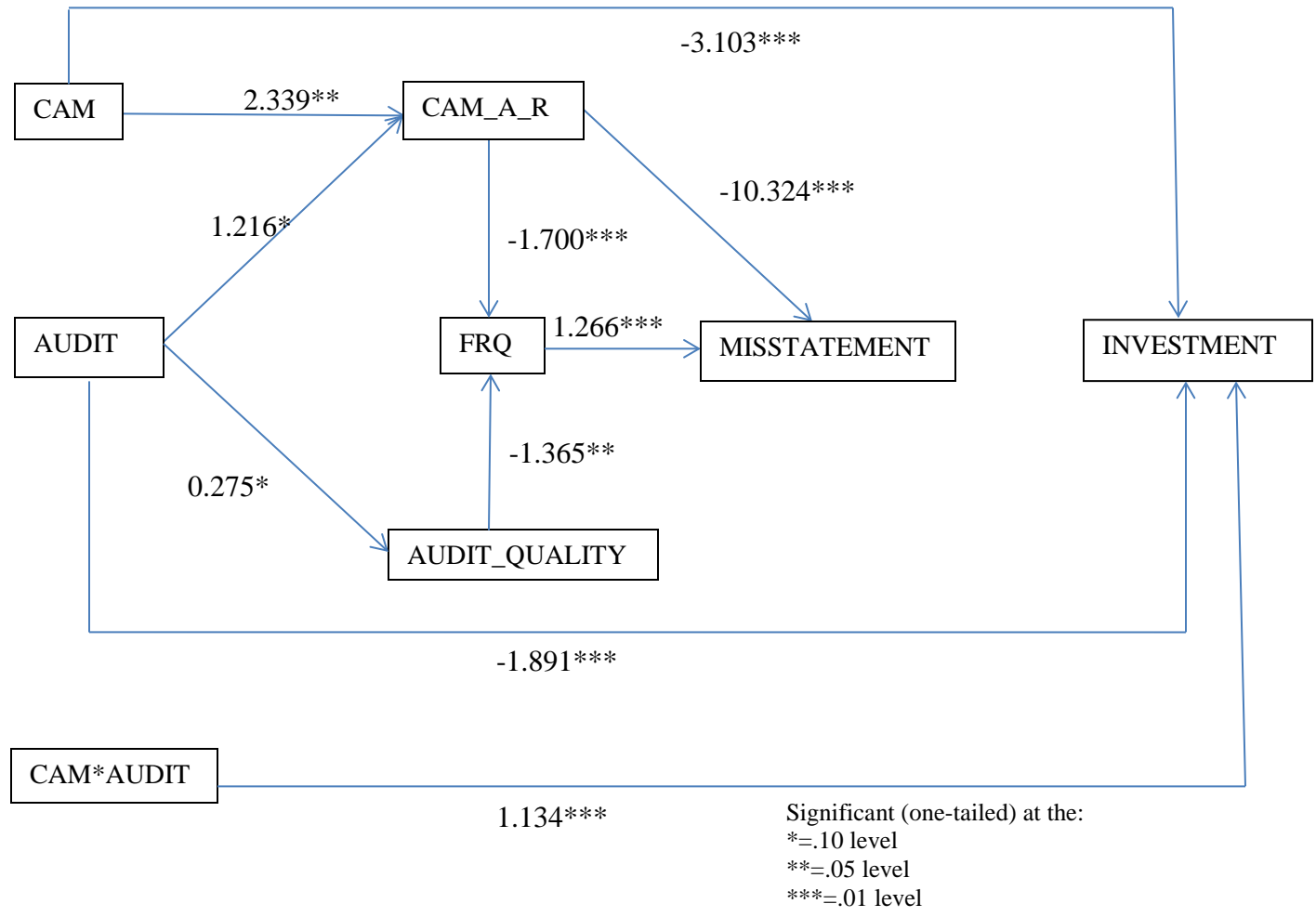


Figure 8: Results of Best Fit Model

6. SUPPLEMENTARY ANALYSIS

6.1 Controlling for Joint Assessments

The results of my primary analysis may be the result of a joint assessment of both Aubrek (manipulated firm) and Bedous (control firm). To address this concern, I conduct several sets of supplementary testing with a difference variable computed from the difference in assessments between Aubrek Banking and Bedous Banking.

The tests of H1, H2, H3, and H4 are re-examined using the methodology described above. I conduct supplemental analysis of H1 with a two-way MANOVA; CAM_DETAIL and AUDIT_DETAIL are the independent variables and the difference in CAM accuracy and reliability assessments between Aubrek Banking and Bedous Banking are the dependent variables of interest. The results are significant for CAM_DETAIL when the dependent measure is CAM reliability ($F(1,72)=3.686, p=.0295$) and are significant when the dependent measure is CAM accuracy ($F(1,72)=2.203, p=.071$). These results are consistent with my primary analysis and provide additional support for H1.

**Table 8 - MANOVA Results for CAM Accuracy and Reliability with
AUDIT_DETAIL and CAM_DETAIL**

Panel A - Cell Means (Standard Deviation) for CAM Accuracy

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	.33 (0.73)	0.00 (0.50)
	Generic	-0.06 (0.43)	0.00 (0.55)

Panel B- Cell Means (Standard Deviation) for CAM Reliability

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	0.19 (0.51)	0.06 (0.43)
	Generic	-0.06 (0.43)	-0.10 (0.44)

Panel C - Two-Way MANCOVA Results

	Value	F	Sig.
CAM - Wilks' Lambda	0.948	1.933	0.152
AUDIT - Wilks' Lambda	0.984	0.565	0.571
CAM*AUDIT - Wilks' Lambda	0.967	1.194	0.309

Table 8 (Continued)
Panel D - Two-Way MANOVA Results

DV: CAM_ACCURACY_DIFF

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.722	1	0.722	2.203	0.071
AUDIT	0.354	1	0.354	1.08	0.302
CAM*AUDIT	0.722	1	0.722	2.203	0.071
ERROR	23.608	72	0.328		
Total	26	76			

DV: CAM_RELIABILITY_DIFF

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.764	1	0.764	3.686	0.0295
AUDIT	0.133	1	0.133	0.64	0.426
CAM*AUDIT	0.043	1	0.043	0.205	0.652
ERROR	14.93	72	0.207		
Total	16	76			

Supplemental analysis of H2 is tested similarly to methodology used to supplement H1 using the same MANOVA results. Unfortunately, the results are not significant for either CAM accuracy ($F(1,72)=1.08$, $p=.302$) or CAM reliability ($F(1,72)=0.64$, $p=.426$) failing to provide supplemental support for H2.

Next, I conduct supplemental analysis on H3 by controlling for assessments of the control firm. A two-way ANOVA with AUDIT_DETAIL as the independent variable and the difference in assessments of audit quality between Aubrek Banking and Bedous Banking is significant ($F(1,72)=4.453$, $p=.019$). The pattern of means conforms to the predictions of H3. When AUDIT_DETAIL is detailed, nonprofessional investors assess audit quality to be higher relative to when AUDIT_DETAIL is generic. These results are consistent with Support Theory, where more pieces of supporting evidence result in higher probability assessments in the parent hypothesis (e.g. that audit quality is high).

**Table 9 - ANOVA Results for Audit Quality Differences with AUDIT_DETAIL and CAM_DETAIL
Panel A - Cell Means (Standard Deviation) for Audit Quality Difference**

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	0.30 (0.63)	0.05 (0.23)
	Generic	-0.02 (0.21)	-0.03 (0.35)

Panel B - Two-Way ANOVA Results

DV: AUDIT_QUALITY_DIFF

	Sum of Squares	df	Mean Square	F	Sig.
CAM	0.83	1	0.283	1.682	0.10
AUDIT	0.749	1	0.749	4.453	0.019
CAM*AUDIT	0.269	1	0.269	1.601	0.105
ERROR	12.108	72	0.168		
Total	14.03	76			

Finally, I conduct supplemental testing of H4. I conduct a two-way ANOVA with CAM_DETAIL and AUDIT_DETAIL as the independent variables and the difference in financial reporting quality assessments between Aubrek Banking and Bedous Banking as the dependent variable of interest. The results (un-tabulated) are not significant ($F(1,72)=.929$, $p=.338$) failing to provide supplemental support for H4.

6.2 Supplemental Analysis of Investment Decisions

I further investigate whether my manipulated independent variables have any impact on nonprofessional investors' investment decisions. The results of the path analysis suggest that

there is an impact of CAM disclosure detail and related audit procedure disclosure detail on investment in Aubrek Banking (the manipulated firm).

I conduct a two-way ANOVA with CAM_DETAIL and AUDIT_DETAIL as the manipulated independent variables and investment in Aubrek Banking the dependent variable of interest. The ANOVA reveals a significant CAM_DETAIL*AUDIT_DETAIL interaction ($F(1,72)=4.793, .032$). Simple effects analysis reveals that when CAM_DETAIL is detailed, nonprofessional investors invest significant more when the related audit procedures are disclosed in greater relative to generic detail ($M=56555.86$ and $M=49007.12$ respectively; the difference of 8319.92 is significant, $p=.026$). This is an interesting result that suggests nonprofessional investors find value when the level of detail for the CAM and related audit procedures disclosures converge at the same level. The practical implications of this result suggest that if the auditor is going to disclose either a CAM account or the related audit procedures in detailed language, nonprofessional investors find the most value or information when the two disclosures converge at the same level in greater detail. This result should encourage regulators who fear that these disclosures may become boilerplate (PCAOB 2016). Evidence that greater detail results in additional value to nonprofessional investors that leads to an increased willingness to invest in the target firm could also be seized upon by management. When a CAM is required to be disclosed, management may be motivated to influence the auditor to disclose the CAM in greater detail as this action would result in the greatest benefit for the firm itself.

Table 10 - ANOVA Results for Investment Judgment
Panel A - Cell Means (Standard Deviation) for Investment Judgment

		Related Audit Procedures Disclosure Detail	
		Detailed	Generic
CAM Disclosure Detail	Detailed	56555.86 (13598.23)	49007.12 (10361.08)
	Generic	48235.94 (8486.66)	51988.57 (11054.51)

Panel B - Two-Way ANOVA Results

	Sum of Squares	df	Mean Square	F	Sig.
CAM	5999952396	1	133871141.100	1.070	.305
AUDIT	9012285604	1	67691171.110	.541	.464
CAM*AUDIT	15012238000	1	599952395.700	4.793	.032
Error	9012285604	72	125170633.400		
Total	2.133x10 ¹¹	76			

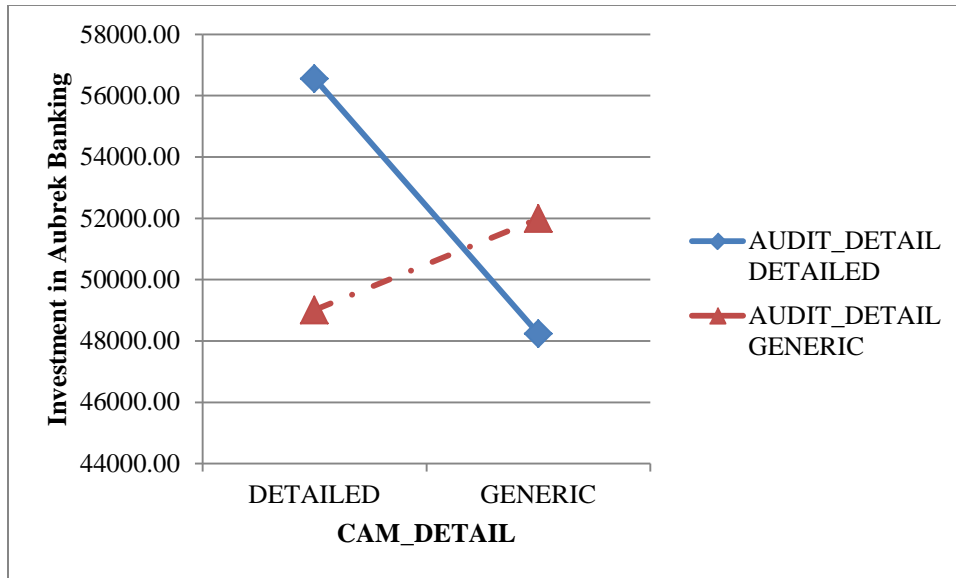


Figure 9: Investment In Aubrek Banking

CAM – Level of CAM disclosure detail, coded as 1=Detailed and 0=Generic

AUDIT – Level of related audit procedure disclosure detail, coded as 1=Detailed and 0=Generic

INVESTMENT – Post Manipulation difference measure of investment in Aubrek Banking; \$0-\$100,000, inclusive

7. DISCUSSION

The objective of this dissertation as a whole is to investigate how expanding the standard audit report will impact nonprofessional investors' confidence in disclosed accounts, assessments of audit quality, assessments of financial reporting quality, and investment judgments.

Specifically, I investigate how the PCAOB's re-proposed standard and the associated principles-based framework could be applied to the expanded audit report and how this expansion impacts nonprofessional investors' perception. Figure 10 provides a summary of the results of the tests of my hypotheses as well as references to the corresponding tables and figures.

7.1 The Effect of CAM Disclosure Detail

The level of detail included in the CAM disclosure appears to impact nonprofessional investors' assessments of the CAM accounts' accuracy and reliability. Hypothesis one states that nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the CAM account is identified with greater detail in the auditor's report relative to when a CAM account is identified with generic detail. H1 is supported with statistical tests.

This result would suggest that the confidence in the accuracy and reliability of accounts that are disclosed as a CAM increases when the CAM account is disclosed in greater detail. This result is consistent with the boundary condition of Support Theory which state that as an individual unpacks pieces of supporting evidence, their assessments of the parent hypothesis, in this case that the CAM account is not accurate or reliable, decreases with additional specific and atypical

evidence, resulting in higher assessments of accuracy and reliability. These results may encourage regulators who wish for the audit report to be more informative and useful for investors. It would appear that nonprofessional investors do indeed use the additional information within the report and find it useful; more detailed disclosures result in higher confidence judgments which may incentivize the auditor to produce more client tailored audit reports.

7.2 The Effect of Related Audit Procedures Disclosure Detail

The level of detail included in the related audit procedures also appears to impact nonprofessional investors' assessments of the CAM accounts' accuracy, but not assessments of reliability. Hypothesis two states that nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the related audit procedures are disclosed in greater detail within the auditor's report relative to when the related audit procedures are disclosed in generic detail within the auditor's report. H2 is supported with statistical tests. This result would suggest that the confidence in the accuracy of accounts that are disclosed as a CAM increases when the related audit procedures engaged to address the CAM account are disclosed in greater detail. This result is consistent with the boundary condition of Support Theory which states that as an individual unpacks pieces of specific supporting evidence, their assessments of the parent hypothesis, in this case that the CAM account is not accurate, decreases, resulting in higher assessments of accuracy. Again, this result may encourage regulators who wish for the audit report to be more informative and useful. It would appear that nonprofessional investors do indeed use the additional information within the report and find it useful; more detailed disclosures result in higher confidence judgments which may incentivize the auditor provide information specific to the client firm in the audit report.

The effect of related audit procedure disclosure detail on assessments of audit quality was also captured. Hypothesis three states that nonprofessional investors will assess audit quality higher when the related audit procedures are described in greater detail within the auditor's report relative to when the related audit procedures are described in generic detail within the auditor's report. H3 is supported with statistical tests. It would appear that the description of the related audit procedures does impact nonprofessional investors' assessment of audit quality; more detailed descriptions of the related audit procedures results in significantly higher assessments of audit quality relative to generic descriptions of related audit procedures. This result is consistent with the intuitive predictions of Support Theory. As regulators develop the final rule for promulgation, this result may ease practitioners' fear of decreasing perceptions of audit quality if the objective of the new standard is indeed to provide detailed disclosures for every firm.

7.3 SEM Results and Inferences

The results of my SEM model provide interesting insight into the process through which nonprofessional investors incorporate the information contained within CAM disclosures and related audit procedures into their assessments. Hypothesis 5a states that nonprofessional investors' confidence in the accuracy and reliability of a CAM account will positively mediate the relationship between CAM disclosure language and assessments of financial reporting quality. The results of the path analysis are significant and indicative of full mediation; however, the path coefficient for the total indirect effect is negative, suggesting that more detailed CAM disclosures actually *decrease* assessments of financial reporting quality.

Hypothesis 5b states that nonprofessional investors' assessment of audit quality will positively mediate the relationship between audit procedure disclosure language and assessed

financial reporting quality. Similar to H5a, the path analysis is significant and suggests full mediation. However, the total indirect effect of AUDIT on FRQ is negative, suggesting that related audit procedures disclosed in greater detail decrease assessments of audit quality. Taken together, the results of H5a and H5b may discourage auditors from providing CAM disclosures that are highly specific to the client firm which would be counter to the objectives of the PCAOB and the desires of the investing public.

Hypothesis 6a states that nonprofessional investors' confidence in the accuracy and reliability of a CAM account will negatively mediate the relationship between CAM disclosure language and assessed probability of material misstatement. The results of the path analysis support this position where the total indirect effect of CAM disclosure detail negatively impacts assessments of future misstatement; in other words, when nonprofessional investors have greater confidence in the accuracy and reliability of the CAM account, they assess a lower probability of misstatement in the financial statements.

Hypothesis 6b states that nonprofessional investors' assessments of audit quality will negatively mediate the relationship between audit procedures disclosure language and assessed probability of material misstatement. The results of the path model are significant, but in the unhypothesized direction. These results suggest that the disclosure more detailed audit procedures leads to higher assessments of future material misstatement. This result is not totally surprising; when audit procedures are disclosed in greater detail it may communicate to nonprofessional investors that they auditor had to exert greater effort on a subjective and uncertain account. Despite the auditor's best efforts, the account may still be uncertain and subjective, leading to higher probability assessments of misstatements

Hypothesis 7 states that nonprofessional investors' assessments of financial reporting quality will negatively impact their assessed misstatement probability. The path coefficient from FRQ to MISSTATEMENT is significant but was opposite the predicted direction. Finally, Hypothesis 8 states that nonprofessional investors' assessment of misstatement probability will negatively impact their decision to invest in the target firm and the magnitude of their investment. The results of the path model do not provide support for H8; however, a supplementary ANOVA does find evidence that CAM disclosure detail interacting with related audit procedure disclosure detail does have a significant, positive impact on nonprofessional investors' investment decisions. This finding will be of interest to regulators and audit client management. This result could incentivize client management to influence the language within the CAM disclosure to make the firm appear to be a more attractive investment; however, auditors may not acquiesce to this request if perceptions of audit quality decrease with more detailed disclosures.

Hypotheses	Theory - Effect	Result	Tests
H1: Nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the CAM account is identified with a detailed disclosure in the auditor's report relative to when a CAM account is identified with a generic disclosure.	Support Theory	Supported	Table 3
H2: Nonprofessional investors will be more confident in the accuracy and reliability of the CAM account when the audit procedures engaged to address the CAM are disclosed in greater detail relative to generic detail.	Support Theory	Supported	Table 3
H3: Nonprofessional investors will assess audit quality higher when the related audit procedures are described with greater detail in the auditor's report relative to when the related audit procedures are described with generic detail in the auditor's report.	Support Theory	Supported	Table 4
H4: Nonprofessional investors will assess financial reporting quality as higher when the related audit procedures are described in greater detail within the auditor's report relative to when the related audit procedures are described in generic detail within the auditor's report.	Support Theory	Not Supported	Table 5
H5a: Nonprofessional investors' confidence in the accuracy and reliability of a CAM account will positively mediate the relationship between CAM disclosure language and assessments of financial reporting quality.	Support Theory	Not Supported*	Table 7
H5b: Nonprofessional investors' assessment of audit quality will positively mediate the relationship between audit procedure disclosure language and assessed financial reporting quality.	Support Theory	Not Supported*	Table 7
H6a: Nonprofessional investors' confidence in the accuracy and reliability of a CAM account will negatively mediate the relationship between CAM disclosure language and assessed probability of material misstatement.	Support Theory	Supported	Table 7
H6b: Nonprofessional investors' assessments of audit quality will negatively mediate the relationship between audit procedures disclosure language and assessed probability of material misstatement.	Support Theory	Not Supported*	Table 7
H7: Nonprofessional investors' assessments of financial reporting quality will negatively impact their assessed misstatement probability.	Support Theory	Not Supported*	Table 7
H8: Nonprofessional investors' assessment of misstatement probability will negatively impact their decision to invest in the target firm and the magnitude of their investment.	Support Theory	Not Supported	Figure 5
* Results are significant but do not conform to directional predictions.			

Figure 10 – Summary of Results

8. CONCLUSION

8.1 Implications

The investing public has been lobbying regulators for years to expand the standard auditor's report to create a more informative and useful disclosure. My experiment examines how the principles-based framework of the PCAOB's re-proposed rule would impact nonprofessional investors' judgments. It is shown that the expanded disclosures do enter into nonprofessional investors' judgments and that the level of detail present in the disclosure of the CAM account and the related audit procedures results in differential judgments. However, it is shown that increased disclosure detail results in higher levels of confidence in the disclosed accounts. Evidence is also provided that more descriptive related audit procedures increase nonprofessional investors' assessments of audit quality. These findings may provide an incentive to auditors to fulfill their regulatory mandate from an information medium perspective and disclose detailed information. As Professor Carcello stated during the IAG's October meeting, if the ultimate result of this new rule is that the audit report again becomes boilerplate, the PCAOB should refrain from promulgating a final rule (IAG 2016). Here, I provide evidence that more detailed CAM account disclosures and more detailed related audit procedures result in greater confidence in the accuracy and reliability of the disclosed account and higher assessments of audit quality. Further, I provide supplementary evidence that detailed CAM and audit procedure disclosures interact to impact nonprofessional investors' investment decisions.

8.2 Limitations

This research is subject to several limitations. First, the experimental setting of the financial services industry was purposefully selected to make the CAM manipulation more uncertain and salient to participants. The effect of CAM disclosure detail and audit procedure detail may not be observed in industries that nonprofessional investors are more familiar with or are not native to complex financial transactions and instruments. Third, the significant main effect observed for the inclusion of the CAM on several dependent measures may be an artifact of my experimental setting. Critical audit matters are not presently disclosed in the audit report; therefore, the simple appearance of a CAM may itself have been the driving force behind the observed effect instead of the content of the critical audit matter itself. With the literature on CAM's effect on nonprofessional investors' judgments still in its infancy it is difficult to say whether this effect is systematically caused by the inclusion of a CAM or is due to the novel nature of not having been exposed to CAMs before this experiment. Third, the auditor's report was "pushed" to participants in the experimental case, making its contents very salient. It is unknown if the effects observed here would manifest itself in an environment where the auditor's report is contained within several hundred pages of a firm's annual report and, therefore, less salient. Finally, since the disclosure of a CAM is a novel piece of information, information was provided for two companies in the same industry, including the financial statements, notes to the financial statements, and the audit reports. It is unlikely that nonprofessional investors review audit reports side-by-side and compare the details of the reports; this would be unsurprising as the current audit report is boilerplate and any departures from an unqualified opinion would signal dire news. However, given the PCAOB's proposal to make the audit report more useful and informative, it is not difficult to imagine that investors will now compare the details within

the CAMs to other CAMs within an industry when making audit quality and financial reporting quality judgments.

8.3 Future Research

This paper highlights several opportunities for future research. First, the detail with which the CAM is described is just one factor that may influence nonprofessional investors' judgments. The sentiment, vividness, and valence of such disclosures may prove to be significant determinants of confidence in the financial statements as well. Second, audit procedures may be described in terms other than detailed and generic disclosures. Future research could identify the conditions where audit procedure description significantly impact nonprofessional investors' judgments as well as interact with CAM disclosure. Third, this paper investigates the judgments of one subset of nonprofessional investors. More or less sophisticated nonprofessional investors may exhibit differential judgments in the presence of CAM disclosure detail and audit procedure detail. Finally, while not explicitly required nor prohibited under the re-proposed rule, the results of the related audit procedures may end up being disclosed in the expanded audit report. Indeed, there is significant pressure from investors as well as the PCAOB's Investor Advisory Group to disclose this additional information (IAG 2016). Future research could investigate whether disclosing the results of related audit procedures does indeed result in differential investing judgments.

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APPENDICES

Appendix A: Experimental Instrument

Informed Consent

Instructions: The purpose of this research study is to obtain information about nonprofessional investors' judgments and behavior. You will be asked to assume the role of a nonprofessional investor throughout the entire study. You will be asked to read narratives and provide your decisions based on the information provided. The information provided in the set of materials is intended to be representative rather than complete. Please be sure to base your opinions and perceptions only on the information provided in this case. There are no right or wrong answers. Please carefully read all information provided before responding to the questions. For your participation you will receive \$2.50 payable to your Amazon Mechanical Turk account.

The purpose of this research study is to put you in the role of a nonprofessional investor and to gather data about your decisions based on information concerning a firm's financial performance. This research study is being conducted via an online instrument presented in a setting of your choice that should take approximately 30 minutes to complete.

No identifying information will be used. In order to meet inclusion criteria for this study, you must be at least 18 years of age and have experience investing in individual stocks and reviewing financial statements. Physical/mental/health status, gender, occupation, and/or diagnosis are not criteria for inclusion in or exclusion from this study.

Your participation is voluntary and your responses will be kept confidential. The person in charge of this research study is Peter Kipp and he is called the Principal Investigator. However, other research staff may be involved and can act on behalf of the person in charge. This research is considered of minimal risk. The risks from participating in this study are not more than would be encountered in everyday life. While your participation in this study will help advance the body of knowledge regarding nonprofessional investors' judgments, we are unsure if you will receive any benefits by taking part in this research study.

Your privacy and research records will be kept confidential to the full extent of the law. Authorized research personnel, employees of the Department of Health and Human Services, and the USF Institutional Review Board and its staff, and any other individuals acting on behalf of USF, may inspect the records from this research project.

You may choose not to participate in this study. Refusal to take part in this study will involve no penalty or loss of benefits to which you would otherwise be entitled. You may discontinue participation in this study at any time without penalty or loss of benefits to which you may otherwise be entitled.

This study, titled “NonProfessional Investor Judgments” is approved USF IRB # 29477. If you have any questions or concerns about this study, please contact Peter Kipp at 813-974-6863. If you have questions about your rights as a participant in this study, general questions, or complaints, concerns or issues you want to discuss with someone outside the research study, call the Division of Research Integrity and Compliance at the University of South Florida at 813-974-5638. By proceeding to the next page, you are agreeing to participate in this study.

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Survey Instructions

On the screens that follow you will be presented with background information, summary financial statements, and the independent auditor's report for two companies operating in the same industry. Please pay close attention to the information you are provided. After reviewing the information, you will be asked to compare the two companies on a number of dimensions and will be asked to make an investment decision related to the two companies. Please base your responses only on the information contained within the case. There are no right or wrong answers to any of the questions in the case. While viewing the case materials you may use the "Previous" button at the bottom of the screen to return to previous screens and review information if necessary. Please complete the case in a single sitting. When you are finished, a message will appear thanking you for your participation and informing you how to receive your compensation.

Case Background Information

The information in this case is prepared following prospective accounting and auditing standards, which may differ from current accounting and auditing standards. Assume that the accounting standards are as stated in the case in the event they differ from current standards. For the entirety of this case, please assume the role of an investor who is evaluating the 2016 audited financial statements of Aubrek Banking and Bedous Banking. Both Aubrek Banking and Bedous Banking are publicly traded global financial service firms based in New York City, NY. Aubrek Banking and Bedous Banking are competitors and both companies provide consumer and commercial banking services, securities brokerage and investment banking services, investment advisory services, and venture capital investment services. Both companies are listed on the NASDAQ exchange. Both Aubrek Banking and Bedous Banking are committed to meeting analysts' forecasts and have not missed a forecast target in the past three years. Further, upper management has a large incentive to meet analysts' forecasts because the upper management of both companies is compensated almost entirely with bonuses for meeting analysts' forecasts. For the period ending December 31, 2015, the earnings per share (EPS) forecast target for both Aubrek Banking and Bedous Banking was \$1.42. You are to evaluate the financial position of Aubrek Banking and Bedous Banking using the most recent financial data available to you.

If the management of either Aubrek Banking or Bedous Banking were to make an estimate for an expense, would it be in the best interest of management to estimate the expense lower or higher?

- Lower
- Higher

Assume that Aubrek Banking and Bedous Banking have the audited financial statements shown below for the years ended December 31, 2014 and December 31, 2015.

Aubrek Banking

Income Statement

	Year Ended		
	December 31, 2015 (amounts in thousands)	December 31, 2014 (amounts in thousands)	December 31, 2013 (amounts in thousands)
Interest Income	\$ 49,800	\$ 51,886	\$ 50,329
Interest Expense	\$ 10,549	\$ 10,934	\$ 10,606
Net Interest Income	\$ 39,251	\$ 40,952	\$ 39,723
Noninterest Income	\$ 49,256	\$ 44,295	\$ 42,966
Noninterest Expense	\$ 59,192	\$ 61,117	\$ 59,283
Net Noninterest Income	\$ (9,936)	\$ (16,822)	\$ (16,317)
Net Interest and Noninterest Income	\$ 29,315	\$ 24,130	\$ 23,406
Less: Provision for Credit Losses	\$ 2,958	\$ 2,275	\$ 2,207
Net Income after Provision	\$ 26,358	\$ 21,855	\$ 21,199
Less: Goodwill Impairment	\$ 2,752	\$ -	\$ -
Less: Other Expenses	\$ 2,932	\$ 2,413	\$ 2,341
Income before Income Taxes	\$ 20,674	\$ 19,442	\$ 18,859
Income Tax Expense	\$ 6,202	\$ 5,833	\$ 5,658
Net Income	\$ 14,472	\$ 13,609	\$ 13,201
Earnings Per Share (EPS)	\$ 1.45	\$ 1.36	\$ 1.32

Bedous Banking Income Statement

	Year Ended		
	December 31, 2015 (amounts in thousands)	December 31, 2014 (amounts in thousands)	December 31, 2013 (amounts in thousands)
Interest Income	\$ 48,804	\$ 52,405	\$ 50,833
Interest Expense	\$ 10,654	\$ 11,043	\$ 10,712
Net Interest Income	\$ 38,150	\$ 41,362	\$ 40,121
Noninterest Income	\$ 50,734	\$ 43,321	\$ 42,021
Noninterest Expense	\$ 59,784	\$ 60,506	\$ 58,691
Net Noninterest Income	\$ (9,050)	\$ (17,185)	\$ (16,670)
Net Interest and Noninterest Income	\$ 29,099	\$ 24,176	\$ 23,451
Less: Provision for Credit Losses	\$ 2,987	\$ 2,298	\$ 2,229
Net Income after Provision	\$ 26,112	\$ 21,878	\$ 21,222
Less: Goodwill Impairment	\$ 2,712	\$ -	\$ -
Less: Other Expenses	\$ 2,619	\$ 2,418	\$ 2,345
Income before Income Taxes	\$ 20,781	\$ 19,461	\$ 18,877
Income Tax Expense	\$ 6,234	\$ 5,838	\$ 5,663
Net Income	\$ 14,547	\$ 13,623	\$ 13,214
Earnings Per Share (EPS)	\$ 1.45	\$ 1.36	\$ 1.32

Note: Both Aubrek Banking and Bedous Banking were forecasted to report earnings per share (EPS) of \$1.42 for the period ending December 31, 2015.

Please answer the following questions for both Aubrek Banking and Bedous Banking.

In your opinion, what is the likelihood (0-100%) that the company's provision for credit losses account contains a misstatement that you would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the likelihood (0-100%) that the **company's goodwill impairment account** contains a **misstatement** that **you** would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the likelihood (0-100%) that the **company's income statement** as a whole contains a **misstatement** that **you** would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the likelihood (0-100%) that the **company's provision for credit losses account** contains a **misstatement** that **other investors** would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the likelihood (0-100%) that the **company's goodwill impairment account** contains a **misstatement** that **other investors** would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the likelihood (0-100%) that the **company's income statement** as a whole contains a **misstatement** that **other investors** would consider important?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

For the next question, please assume that you have **\$100,000** to invest. You may choose to invest the \$100,000 in Aubrek Banking, Bedous Banking, or in any combination of the two companies. However, the **TOTAL** amount invested must be equal to \$100,000. Please note that the sliders may not be moved into a position that totals more than \$100,000.

Investment in Aubrek Banking

\$0					\$50,000					\$100,000
0	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000

Investment in Bedous Banking

\$0					\$50,000					\$100,000
0	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000

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Background Information

The audit firm for **Aubrek Banking** is **Auldley Hoffman, LLP**, a "Big 4" accounting firm that employs over 150,000 accountants and staff in 140 countries and is generally accepted to have an outstanding reputation for providing assurance on the financial statements of publicly traded companies. The audit firm for **Bedous Banking** is **Darbron Hanks, LLP**, another "Big 4" accounting firm with attributes similar to those of Auldley Hoffman, LLP.

The standards of the Public Company Accounting Oversight Board (PCAOB) require that the auditor plan and perform the audit to obtain **reasonable assurance** about whether the financial statements are **free of material misstatement**.

Beginning in 2016, the Independent Auditor's Report contains a section devoted to **critical audit matters** or **CAMs**. **Critical audit matters**, as defined by the Public Company Accounting Oversight Board (PCAOB), are those matters that were identified over the course of the audit by the external auditor and: **1) relates to accounts or disclosures that are material to the financial statements, and 2) involved the auditor's especially challenging, subjective, or complex judgments.**

To fully comply with the new PCAOB standard, **the auditor is required to describe the audit procedures performed to address the critical audit matter during the audit.** The PCAOB allows the **auditor discretion in how the CAM is described in the audit report and how to disclose the audit procedures that were engaged to address the CAM.** Finally, the PCAOB standard **explicitly** states that the inclusion of a CAM in the auditor's report **does not** in any way impact the overall audit opinion on the financial statements or offer a separate level of assurance for the CAM account disclosed.

Please open [this link](#) to view Auldley Hoffman's Independent Auditor's Report for Aubrek Banking and Darbron Hanks' Independent Auditor's Report for Bedous Banking. **Please read the information within the audit report carefully as you answer the case questions.**

Note: You may keep the tab open to reference the auditor's report as you are answering the case questions for your convenience (you will later be asked to close the tab after you have finished the case). You will also find Auldley Hoffman's Independent Auditor's Report for Aubrek Banking and Darbron Hanks' Independent Auditor's Report for Bedous Banking on the following pages.

I have clicked the highlighted link above and have the auditor's reports open in a separate tab.

- Yes
- No

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Aubrek Banking was issued an **unqualified opinion** from **Audley Hoffman, LLP** for the years ending December 31, 2015 and December 31, 2014. In compliance with Public Company Accounting Oversight Board (PCAOB) auditing standards, the audit report also contained the following **critical audit matter** for the year ending December 31, 2015.

Critical Audit Matters – (*Italicized, underlined* text included in detailed disclosure conditions only)

The critical audit matter communicated below is a matter arising from the current period audit that was communicated or required to be communicated to the audit committee and that: **(1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments.** Critical audit matters do not alter in any way our opinion on the financial statements, taken as a whole, and we do not provide separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Provision for Credit Losses - New Loan Product

As more fully described in Notes 1 and 7 to the financial statements, during 2015, Aubrek Banking began actively marketing a nine-year collateralized loan obligation instrument in addition to the three- and five-year collateralized loan obligation instruments historically marketed. At December 31, 2015, the nine-year loans represented approximately 25% of the collateralized loan obligation instrument portfolio. The provision for credit losses is estimated by management through the application of judgment and the use of highly subjective assumptions.

We determined that the provision for credit losses is a critical audit matter due, in part, to the involvement of our complex and subjective judgments in evaluating management's estimates and the significance of their judgments.

[Specifically, these estimates and judgments included such items as the limited historical loss data for the new loan program, the qualitative adjustments to the model for estimating the provision for credit losses, and the sensitivity of the historical loss model to subjective estimates, among others.]

Auditor's Response to the Critical Audit Matter

We planned and performed several procedures related to the provision for credit losses for the nine-year loans in connection with forming our overall opinion on the financial statements.

These procedures included, among other procedures, testing the design and operating effectiveness of key controls over the Company's new model, [including the test of controls over the impairment calculation models including data inputs, controls over collateral valuation estimates, and governance controls including attending key meetings that form part of the approval process for loan impairment provisions].

We compared management's assumptions for both collective and individual impairment allowances to externally available data, [including a critical assessment of management's revisions to estimates and assumptions, specifically in respect of the inputs to the impairment models in the commercial and global banking portfolios and the consistency of judgment applied in the use of the economic factors, loss emergence periods, and the observation period for historical default rates].

Finally, we performed detailed testing on a sample of new and existing models used to calculate both unidentified and identified impairment, [including testing of the coding used in the impairment models, re-performance of the calculation, testing the extraction of data used in the models, and testing and applying sensitivities to the underlying critical assumptions].

Auldley Hoffman, LLP
New York City, NY
March 1, 2016

Bedous Banking was issued an **unqualified opinion** from **Darbron Hanks, LLP** for the years ending December 31, 2015 and December 31, 2014. In compliance with Public Company Accounting Oversight Board (PCAOB) auditing standards, the audit report also contained the following **critical audit matter** for the year ending December 31, 2015.

Critical Audit Matters – (Same across conditions)

The critical audit matter communicated below is a matter arising from the current period audit that was communicated or required to be communicated to the audit committee and that: **(1) relates to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments.** Critical audit matters do not alter in any way our opinion on the financial statements, taken as a whole, and we do not provide separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Provision for Credit Losses - New Loan Product

As more fully described in Notes 2 and 13 to the financial statements, during 2015, Bedous Banking began actively marketing a nine-year collateralized loan obligation instrument in addition to the three- and five-year collateralized loan obligation instruments historically marketed. At December 31, 2015, the nine-year loans represented approximately 25% of the collateralized loan obligation instrument portfolio. The provision for credit losses is estimated by management through the application of judgment and the use of highly subjective assumptions.

We determined that the provision for credit losses is a critical audit matter due, in part, to the involvement of our complex and subjective judgments in evaluating management's estimates and the significance of their judgments, among other considerations.

Auditor's Response to the Critical Audit Matter

We planned and performed several procedures related to the provision for credit losses for the nine-year loans in connection with forming our overall opinion on the financial statements.

These procedures included, among other procedures, testing the design and operating effectiveness of key controls over the Company's new model.

We compared management's assumptions for both collective and individual impairment allowances to externally available data.

Finally, we performed detailed testing on a sample of new and existing models used to calculate both unidentified and identified impairment.

Darbron Hanks, LLP
New York City, NY

March 1, 2016

<The following was only seen by participants in the Control Condition>

Aubrekk Banking was issued an **unqualified opinion** from **Audley Hoffman, LLP** for the years ending December 31, 2015 and December 31, 2014. In compliance with Public Company Accounting Oversight Board (PCAOB) auditing standards, the audit report also contained the following **critical audit matter statement** for the year ending December 31, 2015.

Critical Audit Matters

Critical audit matters are matters arising from the current period audit that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

Audley Hoffman, LLP
New York City, NY
March 1, 2016

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Notes to the Financial Statements (Seen in all conditions)

Note 7 to the financial statements, referenced in the Auditor's Report for **Aubrekk Banking**, may be found below. **Note 1** to the financial statements explains the Company's Significant Accounting Principles, including the Provision for Credit Losses.

NOTE 1. Summary of Significant Accounting Policies
Provision for Credit Losses

The provision for credit losses, which includes the allowance for loan and lease losses and the reserve for unfunded lending commitments, represents management's estimate of probable losses inherent in the Company's lending activities. The allowance for loan and lease losses represents the estimated probable credit losses on funded consumer and commercial loans and leases. Lending-related credit exposures deemed to be uncollectible, excluding loans carried at fair value, are charged off against these accounts. Write-offs on purchased credit-impaired loans on which there is a valuation allowance are recorded against the valuation allowance. Cash recovered on previously charged-off amounts is recorded as a recovery to these accounts. Management evaluates the adequacy of the provision for credit losses based on the combined total of the allowance for loan and lease losses and the reserve for unfunded lending commitments. The Company performs periodic and systematic detailed reviews of its lending portfolios to identify credit risks and to assess the overall collectibility of those portfolios. Loss forecast models are utilized for these portfolios which consider a variety of factors including, but not limited to, historical loss experience, estimated defaults or foreclosures based on portfolio trends, delinquencies, bankruptcies, economic conditions, and credit scores.

NOTE 7. Provision for Credit Losses

In 2015, the Company developed a new nine-year collateralized loan obligation instrument representing 25% of our total collateralized loan obligation portfolio. Due to the nine-year instruments possessing characteristics that were similar to our existing three-year and five-year collateralized loan obligation instruments, we calculated the provision for the nine-year instruments with similar models and estimates.

Note 13 to the financial statements, referenced in the Auditor's Report for **Bedous Banking**, may be found below. **Note 2** to the financial statements explains the Company's Significant Accounting Principles, including the Provision for Credit Losses.

NOTE 2. Summary of Significant Accounting Policies
Provision for Credit Losses

The provision for credit losses, which includes the allowance for loan and lease losses and the reserve for unfunded lending commitments, represents management's estimate of probable losses inherent in the Company's lending activities. The allowance for loan and lease losses represents the estimated probable credit losses on funded consumer and commercial loans and leases. Lending-related credit exposures deemed to be uncollectible, excluding loans carried at fair value, are charged off against these accounts. Write-offs on purchased credit-impaired loans on which there is a valuation allowance are recorded against the valuation allowance. Cash recovered on previously charged-off amounts is recorded as a recovery to these accounts. Management evaluates the adequacy of the provision for credit losses based on the combined total of the allowance for loan and lease losses and the reserve for unfunded lending commitments. The Company performs periodic and systematic detailed reviews of its lending portfolios to identify credit risks and to assess the overall collectibility of those portfolios. Loss forecast models are utilized for these portfolios which consider a variety of factors including, but not limited to, historical loss experience, estimated defaults or foreclosures based on portfolio trends, delinquencies, bankruptcies, economic conditions, and credit scores.

NOTE 13. Provision for Credit Losses

In 2015, the Company developed a new nine-year collateralized loan obligation instrument representing 25% of our total collateralized loan obligation portfolio. Due to the nine-year instruments possessing characteristics that were similar to our existing three-year and five-year collateralized loan obligation instruments, we calculated the provision for the nine-year instruments with similar models and estimates.

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Following are several questions that will ask for your opinion on the information you have just reviewed. You may use the **previous button** at the bottom of the screen to go back to any of the information (e.g. auditor's report, financial statements, notes the financial statements) as you answer these questions. **Please carefully read each question and use the financial statements, auditor's report, and notes to the financial statements for both firms as you answer each question.**

If you would like to view the **financial statements** for Aubrek Banking and Bedous Banking, please follow this **link** and leave the tab open as you answer the case questions.

If you would like to view the **notes to the financial statements** for Aubrek Banking and Bedous Banking, please follow this **link** and leave the tab open as you answer the case questions. (**Note:** You will be asked to close all financial statement, notes to the financial statements, and audit report tabs before the post experiment questionnaire).

Note: Any responses you make before you return to a previous page will be saved and can be changed before you submit the completed case.

Please be aware that for the following questions you will respond for **Aubrek Banking / Auldley Hoffman, LLP first** and then **Bedous Banking / Darbron Hanks, LLP second.**

<The following case questions were randomized to control for potential order effects>

Reliable information is defined as information that is reasonably free from error and bias and faithfully represents what it purports to represent.

As an investor, how much **confidence** do you have in the **reliability** of the values reported for the firm's *goodwill impairment account specifically?*

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how much **confidence** do you have in the **accuracy** of the values reported for **the firm's goodwill impairment account specifically**?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how **confident** are you that the values reported for **the firm's goodwill impairment account** are **free from bias**?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

For this question, select **one (1)** for **AubreK Banking** and select **seven (7)** for **Bedous Banking**.

AubreK Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

For this question, select **six (6)** for **AubreK Banking** and select **two (2)** for **Bedous Banking**.

AubreK Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Reliable information is defined as information that is reasonably free from error and bias and faithfully represents what it purports to represent.

As an investor, how much **confidence** do you have in the **reliability** of the values reported for the firm's [provision for credit losses account specifically?](#)

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how much **confidence** do you have in the **accuracy** of the values reported for **the firm's provision for credit losses account specifically**?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how **confident** are you that the values reported for **the firm's provision for credit losses account** are **free from bias**?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Reliable information is defined as information that is reasonably free from error and bias and faithfully represents what it purports to represent.

As an investor, how much confidence do you have in the **reliability** of the values reported for the firm's *[income statement as a whole](#)*?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how much **confidence** do you have in the **accuracy** of the values reported for the firm's *[income statement as a whole](#)*?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

As an investor, how **confident** are you that the values reported for the firm's income statement as a whole are free from bias?

Aubrek Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

Bedous Banking

Very Unconfident	Unconfident	Somewhat Unconfident	Neither Confident nor Unconfident	Somewhat Confident	Confident	Very Confident
1	2	3	4	5	6	7

How much do you enjoy eating peanut butter and jelly sandwiches?

Enjoy eating PB&J

Don't enjoy at all			Somewhat enjoy			Really enjoy
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's management is competent.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **management** is **not credible**.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **management** is **trustworthy**.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **management** makes **financial reporting choices** that are **self-serving**.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: Aubrek Banking's management is **more credible** than Bedous Banking's management.

AubreK Banking's Management is more credible than Bedous Banking's Management

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

As an investor, how **informative** was the disclosure in the audit report that **identified** the critical audit matter?

AubreK Banking

Very Uninformative	Uninformative	Somewhat Uninformative	Neither Informative nor Uninformative	Somewhat Informative	Informative	Very Informative
1	2	3	4	5	6	7

Bedous Banking

Very Uninformative	Uninformative	Somewhat Uninformative	Neither Informative nor Uninformative	Somewhat Informative	Informative	Very Informative
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: **The auditor did a high quality job in identifying the critical audit matter.**

AubreK Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The auditor's work would allow them to **accurately identify the critical audit matter** while conducting the audit.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

As an investor, **how independent** do you believe the auditor is **with respect to the firm's management**?

Aubrekk Banking

Very NonIndependent	NonIndependent	Somewhat NonIndependent	Neither Independent nor NonIndependent	Somewhat Independent	Independent	Very Independent
1	2	3	4	5	6	7

Bedous Banking

Very NonIndependent	NonIndependent	Somewhat NonIndependent	Neither Independent nor NonIndependent	Somewhat Independent	Independent	Very Independent
1	2	3	4	5	6	7

As an investor, **how much effort** do you believe **the auditor exerted with their audit procedures to address the firm's critical audit matter** in their audit?

Aubrekk Banking

Very Small Effort	Small Effort	Somewhat Small Effort	Neither a Large nor a Small Effort	Somewhat Large Effort	Large Effort	Very Large Effort
1	2	3	4	5	6	7

Bedous Banking

Very Small Effort	Small Effort	Somewhat Small Effort	Neither a Large nor a Small Effort	Somewhat Large Effort	Large Effort	Very Large Effort
1	2	3	4	5	6	7

As an investor, how appropriate do you believe the auditor was in their response to address the critical audit matter detailed in the audit report for the firm?

Aubrekk Banking

Very Inappropriate	Inappropriate	Somewhat Inappropriate	Neither Appropriate nor inappropriate	Somewhat Appropriate	Appropriate	Very Appropriate
1	2	3	4	5	6	7

Bedous Banking

Very Inappropriate	Inappropriate	Somewhat Inappropriate	Neither Appropriate nor inappropriate	Somewhat Appropriate	Appropriate	Very Appropriate
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The auditor did a **high quality job** in **planning** and **performing the audit procedures that addressed** the critical audit matter for the firm.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

As an investor, how would you assess the **overall competence** of the **auditor** and their work?

Aubrekk Banking

Very Incompetent	Incompetent	Somewhat Incompetent	Neither Competent nor Incompetent	Somewhat Competent	Competent	Very Competent
1	2	3	4	5	6	7

Bedous Banking

Very Incompetent	Incompetent	Somewhat Incompetent	Neither Competent nor Incompetent	Somewhat Competent	Competent	Very Competent
1	2	3	4	5	6	7

As an investor, how would you assess the **overall quality** of the **auditor's** work?

Aubrek Banking

Very Low Quality	Low Quality	Somewhat Low Quality	Neither High nor Low Quality	Somewhat High Quality	High Quality	Very High Quality
1	2	3	4	5	6	7

Bedous Banking

Very Low Quality	Low Quality	Somewhat Low Quality	Neither High nor Low Quality	Somewhat High Quality	High Quality	Very High Quality
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: I believe that **the auditor** conducted a **high quality audit** of the firm.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: I believe that the auditors working at the **auditing firm** are **competent**.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: I agree **with the auditor's** decision to give the firm's financial statements a **clean audit opinion**.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: I believe **other auditors** would have given the **same audit opinion** on the **firm's financial statements**.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's financial statements as a **whole accurately represent their performance**.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **financial statements as a whole** are reliable.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **financial statements as a whole** are biased.

Aubrekk Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please indicate your agreement with the following statement: The company's **financial statements as a whole** are a **good indicator of future performance**.

Aubrek Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Bedous Banking

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

In your opinion, how **subjective** are the amounts reported for the **provision for credit losses account** for the company?

Aubrek Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

Bedous Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

In your opinion, how **subjective** are the amounts reported for the **goodwill impairment account** for the company?

Aubrek Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

Bedous Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

In your opinion, how **subjective** are the amounts reported for the **financial statements as a whole** for the company?

Aubrek Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

Bedous Banking

Very Objective	Objective	Somewhat Objective	Neither Subjective nor Objective	Somewhat Subjective	Subjective	Very Subjective
1	2	3	4	5	6	7

In your opinion, how **uncertain** are the amounts reported for the **provision for credit losses account** for the company?

Aubrekk Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

Bedous Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

In your opinion, how **uncertain** are the amounts reported for the **goodwill impairment account** for the company?

Aubrekk Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

Bedous Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

In your opinion, how **uncertain** are the amounts reported for the **financial statements as a whole** for the company?

Aubrekk Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

Bedous Banking

Very Certain	Certain	Somewhat Certain	Neither Uncertain nor Certain	Somewhat Uncertain	Uncertain	Very Uncertain
1	2	3	4	5	6	7

(NOTE: Question randomization ends here)

In your opinion, what is the **likelihood (0-100%)** that the company's financial statements contain a **material misstatement** in the **provision for credit losses account**?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the **likelihood (0-100%)** that the company's financial statements contain a **material misstatement** in the **goodwill impairment account**?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

In your opinion, what is the **likelihood (0-100%)** that the company's financial statements contain a **material misstatement anywhere** in the **income statement**?

Aubrek Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

Bedous Banking

0%					50%					100%
0	10	20	30	40	50	60	70	80	90	100

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For the next question, please assume that you have **\$100,000** to invest. You may choose to invest the \$100,000 in Aubrek Banking, Bedous Banking, or in any combination of the two companies. However, the **TOTAL** amount invested must be equal to \$100,000. Please note that the sliders may not be moved into a position that totals more than \$100,000.

Investment in Aubrek Banking

\$0					\$50,000					\$100,000
0	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000

Investment in Bedous Banking

\$0					\$50,000					\$100,000
0	10,000	20,000	30,000	40,000	50,000	60,000	70,000	80,000	90,000	100,000

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(NOTE: The following five questions are randomized to control for potential order effects)

How **useful** did you find the **audit report** when making your investment decision?

Aubrekk Banking

Totally Useless	Useless	Somewhat Useless	Neither Useful nor Useless	Somewhat Useful	Useful	Very Useful
1	2	3	4	5	6	7

Bedous Banking

Totally Useless	Useless	Somewhat Useless	Neither Useful nor Useless	Somewhat Useful	Useful	Very Useful
1	2	3	4	5	6	7

How difficult is it to **understand** the company's **financial statements** as a whole?

Aubrekk Banking

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

Bedous Banking

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How difficult is it to **understand** the contents of the company's **audit reports**?

Aubrekk Banking

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

Bedous Banking

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How difficult is it to **compare** the **financial statements** between Aubrek Banking and Bedous Banking?

Financial Statement Comparison

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How difficult is it to **compare** the **audit reports** between Aubrek Banking and Bedous Banking?

Audit Report Comparison

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

(NOTE: Question randomization ends here)

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Manipulation Check

Please close all tabs that you have opened with the financial statements, audit reports, or notes to the financial statements during this case before proceeding to the Post Experiment Questionnaire. Failure to close all other tabs may invalidate your results and disqualify you from receiving compensation.

I confirm that I have closed all tabs that I opened during the experimental case.

- Yes
- No

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Did the auditor identify a **critical audit matter** in the **Independent Auditor's Report** of **Aubrekk Banking**?

- Yes
- No
- Not sure

Did the auditor identify a **critical audit matter** in the **Independent Auditor's Report** of **Bedous Banking**?

- Yes
- No
- Not sure

What **audit opinion** did **Aubrekk Banking** receive from **Auldley Hoffman, LLP**?

- Unqualified opinion
- Qualified opinion
- Adverse opinion

What **audit opinion** did **Bedous Banking** receive from **Darbron Hanks, LLP**?

- Unqualified opinion
- Qualified opinion
- Adverse opinion

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Which account did the auditor of **Aubrekk Banking** identify as a **critical audit matter**?

- Goodwill Impairment
- Provision for Credit Losses
- Depreciation Expense
- None of the above

Which account did the auditor of **Bedous Banking** identify as a **critical audit matter**?

- Goodwill Impairment
- Provision for Credit Losses
- Depreciation Expense
- None of the above

What level of detail was used to describe the **critical audit matter** disclosed in the **independent auditor's report of Aubrek Banking**? (Note: If there was **no critical audit matter** disclosed for Aubrek Banking please answer 1).

Level of detail used to describe the critical audit matter in the audit report

Very Low Level of Detail	Low Level of Detail	Somewhat Low Level of Detail	Neither a Low nor High Level of Detail	Somewhat High Level of Detail	High Level of Detail	Very High Level of Detail
1	2	3	4	5	6	7

What level of detail was used to describe the **critical audit matter** disclosed in the **independent auditor's report of Bedous Banking**? (Note: If there was **no critical audit matter** disclosed for Bedous Banking please answer 1).

Level of detail used to describe the critical audit matter in the audit report

Very Low Level of Detail	Low Level of Detail	Somewhat Low Level of Detail	Neither a Low nor High Level of Detail	Somewhat High Level of Detail	High Level of Detail	Very High Level of Detail
1	2	3	4	5	6	7

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What level of detail was used to describe the **audit procedures** performed to respond to and address the disclosed critical audit matter in the **independent auditor's report of Aubrek Banking**? (Note: If there was **no critical audit matter** disclosed for Aubrek Banking please answer 1).

Level of detail used to describe the audit procedures performed

Very Low Level of Detail	Low Level of Detail	Somewhat Low Level of Detail	Neither a Low nor High Level of Detail	Somewhat High Level of Detail	High Level of Detail	Very High Level of Detail
1	2	3	4	5	6	7

What level of detail was used to describe the **audit procedures** performed to respond to and address the disclosed critical audit matter in the **independent auditor's report of Bedous Banking**? (Note: If there was **no critical audit matter** disclosed for Bedous Banking please answer 1).

Level of detail used to describe the audit procedures performed

Very Low Level of Detail	Low Level of Detail	Somewhat Low Level of Detail	Neither a Low nor High Level of Detail	Somewhat High Level of Detail	High Level of Detail	Very High Level of Detail
1	2	3	4	5	6	7

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Did the **presence** of a critical audit matter (CAM) in the auditor's report for Aubrek Banking or Bedous Banking **change the opinion** of the auditor?

- Yes
- No
- Not sure

Was Aubrek Banking and Bedous Banking located in a regulated industry or an unregulated industry?

- Regulated industry
- Unregulated industry
- Do not recall

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How **difficult** did it feel to read the auditor's report for **AubreK Banking**?

Difficulty of Reading

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How **difficult** did it **feel to read** the auditor's report for **Bedous Banking**?

Difficulty of Reading

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

In your opinion, was the auditor's report for **AubreK Banking** more or less **difficult to read** than the auditor's report for **Bedous Banking**?

Difficulty of Reading

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How **difficult** did it **feel to understand** the auditor's report for **AubreK Banking**?

Difficulty of Reading

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How **difficult** did it **feel to understand** the auditor's report for **Bedous Banking**?

Difficulty of Reading

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

In your opinion, was the auditor's report for **AubreK Banking** more or less **difficult to understand** than the auditor's report for **Bedous Banking**?

Difficulty of Understanding

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How difficult did it feel to **process the information** in the auditor's report for **AubreK Banking**?

Difficulty of Processing the Information

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

How difficult did it feel to **process the information** in the auditor's report for **Bedous Banking**?

Difficulty of Processing the Information

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

In your opinion, was the information in the auditor's report for **AubreK Banking** more or less **difficult to process** than the information in the auditor's report for **Bedous Banking**?

Difficulty of Processing the Information

Very Difficult	Difficult	Somewhat Difficult	Neither Easy nor Difficult	Somewhat Easy	Easy	Very Easy
1	2	3	4	5	6	7

In your opinion, how much information was contained within the auditor's **critical audit matter** disclosure for **Aubrek Banking**?

Information contained within the CAM Disclosure

Very Small Amount of Information	Small Amount of Information	Somewhat Small Amount of Information	Neither a Large nor Small Amount of Information	Somewhat Large Amount of Information	Large Amount of Information	Very Large Amount of Information
1	2	3	4	5	6	7

In your opinion, how much information was contained within the auditor's **critical audit matter** disclosure for **Bedous Banking**?

Information contained within the CAM Disclosure

Very Small Amount of Information	Small Amount of Information	Somewhat Small Amount of Information	Neither a Large nor Small Amount of Information	Somewhat Large Amount of Information	Large Amount of Information	Very Large Amount of Information
1	2	3	4	5	6	7

In your opinion, how much information was contained within the auditor's **response to the critical audit matter** for **Aubrek Banking**?

Information contained within the CAM Disclosure

Very Small Amount of Information	Small Amount of Information	Somewhat Small Amount of Information	Neither a Large nor Small Amount of Information	Somewhat Large Amount of Information	Large Amount of Information	Very Large Amount of Information
1	2	3	4	5	6	7

In your opinion, how much information was contained within the auditor's **response to the critical audit matter** for **Bedous Banking**?

Information contained within the CAM Disclosure

Very Small Amount of Information	Small Amount of Information	Somewhat Small Amount of Information	Neither a Large nor Small Amount of Information	Somewhat Large Amount of Information	Large Amount of Information	Very Large Amount of Information
1	2	3	4	5	6	7

In your opinion, did the **critical audit matter disclosure** for **Aubrek Banking** contain **more information** than the **related notes to the financial statements**?

CAM Disclosure contained less/more information than the Notes to the Financial Statements

Significantly Less Information	Less Information	Somewhat Less Information	Neither More nor Less Information	Somewhat More Information	More Information	Significantly More Information
1	2	3	4	5	6	7

In your opinion, did the **critical audit matter disclosure** for **Bedous Banking** contain **more information** than the **related notes to the financial statements**?

CAM Disclosure contained less/more information than the Notes to the Financial Statements

Significantly Less Information	Less Information	Somewhat Less Information	Neither More nor Less Information	Somewhat More Information	More Information	Significantly More Information
1	2	3	4	5	6	7

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Post-Experiment Questionnaire

The following questions will assess your familiarity with respect to financial statement audits and the auditor. Please answer the questions without reference to the case you have just completed. Your answers to the following questions will not impact your compensation.

Please state your agreement with the following statement: The external auditor provides a **high level** of assurance that the financial statements are free of material misstatement.

Auditor provides a high level of assurance that the F/S are free of material misstatement

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please state your agreement with the following statement: The external auditor provides absolute assurance and guarantees that the financial statements are free of material misstatement.

Auditor guarantees that the financial statements are free of material misstatement

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please state your agreement with the following statement: The external auditor is an objective verifier of information provided by management.

Auditor is an objective verifier of information provided by management

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

Please state your agreement with the following statement: The external auditor is independent from the audited company and the company's management.

Auditor is independent of the company and company's management

Strongly Disagree	Disagree	Somewhat Disagree	Neither Agree nor Disagree	Somewhat Agree	Agree	Strongly Agree
1	2	3	4	5	6	7

How familiar are you with the financial statement audit process?

Familiarity with the Financial Statement Audit Process

Very Unfamiliar	Unfamiliar	Somewhat Unfamiliar	Neither Familiar nor Unfamiliar	Somewhat Familiar	Familiar	Very Familiar
1	2	3	4	5	6	7

How familiar are you with the audit reporting process?

Familiarity with the Audit Reporting Process

Very Unfamiliar	Unfamiliar	Somewhat Unfamiliar	Neither Familiar nor Unfamiliar	Somewhat Familiar	Familiar	Very Familiar
1	2	3	4	5	6	7

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What is your gender?

- Male
- Female

What is your age?

Are you a native English speaker (e.g. English is your first language or one of your first languages)?

- Yes
- No

How many **years** of full-time *degree-related* professional work experience do you have? Please enter your response in the form of a **whole integer**.

Approximately how many times have you analyzed the financial statements of a company (e.g. class project, work related assignment, personal investing, etc.)? Please enter your response in the form of a **whole integer**.

Have you invested in individual stocks in the past year?

- Yes
- No
- I have invested in individual stocks, but not within the past year.

Please select all of the areas in which you have expertise (more than one option may be selected). For this question, please define "expertise" as an area in which you would be comfortable applying for a full-time professional position.

- Finance
- Accounting
- Auditing
- Management
- Marketing
- Tax
- Other
- None of the above

What was the approximate value of your equity holdings as of December 31, 2016?

- \$0
- \$1 - \$10,000
- \$10,001 - \$20,000
- \$20,001 - \$50,000
- \$50,001 - \$100,000
- \$100,001 or more

Approximately how many public company financial statements do you read or refer to during an **average month**?

Approximately how many public company auditor's reports do you read or refer to during an **average year**?

How often do you review the company's financial statements before making an investment decision? **Note: 1=Never, 6=Sometimes, 11=Always.**

Frequency of reviewing financial statements before investing

Never					Sometimes					Always
1	2	3	4	5	6	7	8	9	10	11

How often do you review the auditor's report accompanying the financial statements before making an investment decision? **Note: 1=Never, 6=Sometimes, 11=Always.**

Frequency of reading audit reports before investing

Never					Sometimes					Always
1	2	3	4	5	6	7	8	9	10	11

Q43 If you have an undergraduate degree, what was your major field of study? Note: More than one option may be selected.

- Finance
- Accounting
- Auditing
- Management
- Marketing
- Tax
- Other

Approximately how many **accounting** classes have you taken?

Approximately how many **finance** classes have you taken?

Are you **currently** employed as an external auditor?

- Yes
- No

Have you ever been employed as an external auditor?

- Yes
- No

Are you **currently** employed as an internal auditor?

- Yes
- No

Have you ever been employed as an internal auditor?

- Yes
- No

How many individual stock transactions (not mutual funds) do you engage in per year? (Note: If over 500, please enter 500 for this question.)

Stock Transactions per Year

0	50	100	150	250	300	350	400	450	500
----------	-----------	------------	------------	------------	------------	------------	------------	------------	------------

Do you engage in stock transactions as part of your job duties?

- Yes
- No

How familiar are you with the financial statement audits of publicly traded companies?

Familiarity with financial statement audits.

Very Unfamiliar	Unfamiliar	Somewhat Unfamiliar	Neither Familiar nor Unfamiliar	Somewhat Familiar	Familiar	Very Familiar
1	2	3	4	5	6	7

Appendix B: Descriptive Statistics for Dependent Variables and Covariates

	Mean (Standard Deviation)					
CAM Detail:	Detailed		Generic		Control	Overall
Audit Detail:	Detailed	Generic	Detailed	Generic	Control	Overall
Variables	n=21	n=17	n=17	n=21	n=15	n=76
Dependent Measures						
CAM Accuracy (Aubrek)	3.62 (1.83)	4.00 (1.41)	4.41 (1.50)	4.52 (1.33)	4.64 (1.45)	4.23 (1.54)
CAM Reliability (Aubrek)	3.90 (1.76)	4.53 (1.28)	4.41 (1.50)	4.95 (1.32)	4.64 (1.60)	4.45 (1.52)
Audit Quality (Aubrek)	5.71 (0.69)	5.62 (0.91)	5.25 (0.97)	5.90 (0.60)	4.60 (1.37)	5.49 (0.99)
Financial Reporting Quality (Aubrek)	4.78 (1.25)	5.20 (0.81)	4.90 (0.98)	5.26 (0.62)	4.99 (1.23)	5.02 (1.00)
Investment (Aubrek)	56555.86 (13598.23)	49007.12 (10361.08)	48235.94 (8486.66)	51988.57 (11054.51)	63449.79 (31249.20)	53525.96 (16385.44)
Covariate Measures						
CAM Accuracy (Bedous)	3.29 (1.62)	4.00 (1.32)	4.47 (1.50)	4.52 (1.36)	4.14 (0.95)	4.09 (1.45)
CAM Reliability (Bedous)	3.7143 (1.62)	4.47 (1.28)	4.47 (1.42)	5.05 (1.32)	4.14 (1.10)	4.40 (1.43)
Audit Quality (Bedous)	5.41 (0.63)	5.64 (0.84)	5.19 (0.93)	5.93 (0.60)	5.27 (1.16)	5.53 (0.86)
Financial Reporting Quality (Bedous)	4.70 (1.20)	5.21 (0.80)	4.87 (0.97)	5.24 (0.75)	4.46 (1.18)	4.90 (1.02)
Accounting Classes	3.85 (5.08)	4.29 (4.82)	7.59 (6.62)	4.19 (4.63)	3.86 (5.48)	4.69 (5.37)
Auditor Objectivity	5.86 (0.73)	5.71 (1.10)	5.24 (1.25)	5.86 (1.39)	5.71 (1.20)	5.70 (1.15)
Audit Report Information	4.62 (1.56)	3.47 (1.50)	3.76 (1.48)	4.00 (1.26)	1.57 (1.09)	3.65 (1.69)

Appendix C: IRB Exempt Certification



RESEARCH INTEGRITY AND COMPLIANCE
Institutional Review Boards, FWA No. 00001669
12901 Bruce B. Downs Blvd., MDC035 • Tampa, FL 33612-4799
(813) 974-5638 • FAX (813) 974-7091

2/7/2017

Peter Kipp, CPA
USF School of Accountancy
4202 E. Fowler Ave, BSN 3403
Tampa, FL 33620

RE: **Exempt Certification**
IRB#: Pro00029477
Title: Non-Professional Investor Judgments

Dear Mr. Kipp:

On 2/7/2017, the Institutional Review Board (IRB) determined that your research meets criteria for exemption from the federal regulations as outlined by 45CFR46.101(b):

(2) Research involving the use of educational tests (cognitive, diagnostic, aptitude, achievement), survey procedures, interview procedures or observation of public behavior, unless: (i) information obtained is recorded in such a manner that human subjects can be identified, directly or through identifiers linked to the subjects; and (ii) any disclosure of the human subjects' responses outside the research could reasonably place the subjects at risk of criminal or civil liability or be damaging to the subjects' financial standing, employability, or reputation.

As the principal investigator for this study, it is your responsibility to ensure that this research is conducted as outlined in your application and consistent with the ethical principles outlined in the Belmont Report and with USF HRPP policies and procedures.

Please note, as per USF HRPP Policy, once the Exempt determination is made, the application is closed in ARC. Any proposed or anticipated changes to the study design that was previously declared exempt from IRB review must be submitted to the IRB as a new study prior to initiation of the change. However, administrative changes, including changes in research personnel, do not warrant an amendment or new application.

Given the determination of exemption, this application is being closed in ARC. This does not limit your ability to conduct your research project.

We appreciate your dedication to the ethical conduct of human subject research at the University of South Florida and your continued commitment to human research protections. If you have

any questions regarding this matter, please call 813-974-5638.

Sincerely,

A handwritten signature in black ink that reads "John A. Schinka, Ph.D." in a cursive style.

John Schinka, Ph.D., Chairperson
USF Institutional Review Board