

FARview Podcast Series, written report: #7 Justin Leiby

Society will benefit from looking through an empathic lens

In the FARview Podcast Series, FAR staff members conduct interviews with academics and professionals regarding the practical relevance of academic research in the field of auditing. This written report contains an edited transcript of the interview with Justin Leiby. Justin Leiby is an associate professor of accountancy at the University of Illinois. His research interests are primarily in the area of auditing, focusing on social aspects of auditing, like social status and empathy.

Key points

- We will benefit society and ourselves much more effectively if we view the world, at least partially, through an empathic lens. This also holds for auditing, of course.
- Companies, and the old guard at companies who have been very resistant to the idea of remote work, are being slowly persuaded that remote work can be effective.
- Auditors disagree with the client when a high-status expert disagrees with the client. This is encouraging. We also found that the auditors did not go along with the high-status expert when the expert agreed with the client and didn't provide a good argument for their agreement.
- Auditors know that competence and status are not always the same thing, but they also seem to know that competence isn't enough.

One of Justin Leiby's main research and teaching interests is the role of empathy in auditing, which is covered in the first part of this podcast. In the second part of the podcast, Leiby talks about his current FAR-project (with Anna Gold and Kathryn Kadous) 'The effects of expert status on the audit of complex estimates'.

Could you tell us a bit more about your fascination for the role of empathy in decision-making?

'It is no secret that in many fields, like management, business and engineering, there exists an empathy deficit. Also, the personality profile of an accountant isn't one that generally considers feelings of others, or one that processes things at an emotional level. However, over time, it struck me how much emotions and feelings drive decision-making in the real world, while much research has focused on how emotions and feelings can be taken *out of* decision-making. How do we correct this? Maybe we should rather view this as a reality to embrace, and work with it, not against it. To put a face on it: take COVID-19. Every data point on which decisions are made in business, in medicine and public policy, is a face, a human face with a story, with a set of motivations and social relations. We will benefit society and ourselves much more effectively if we view the world, at least partially, through this lens. We can't take the analytic component out of it, but we can supplement it with other things. This also holds for auditing, of course. For example, I recently created a new master course on risk management and innovation, which uses empathic design thinking ideas to bring more empathy to data. It forces accounting students to consider stakeholder thoughts and feelings and how they might react to risk, before they come up with solutions about how to manage risk.'

How is the idea of bringing empathy into the data represented in your research?

'I'm slowly trying to build this in. The most direct line of empathy in my research is a developing project where we are trying to examine the use of virtual reality (VR) as a

supplement for remote work. We study using VR-settings that immerse users in the same environment, based upon research that VR-environments can be beneficial in the development of empathy and other interpersonal bonds, at least beneficial relative to two-dimensional teleconferencing apps. Social presence and the ability to read verbal and non-verbal cues, like body language, is comforting. And it goes further than that. In the theory we're relying on, there is something that is referred to as 'task embodiment'. It relates to what value the user places on the objects in their surroundings. Not only whether you can see the facial expression, but also whether you feel like you're in the same place with the other person, wanting to understand the surroundings and the other person. One great advantage over, for example, Zoom, is that VR is free from distraction. If you're in Zoom, you can be looking at anything in the room, playing with pencil. In VR you're in a completely immersed world. That embodiment is a key component to building empathy and what is called 'task engagement', such as how much you invest in your performance of a given task.'

The goal of this research would then be to find practical implementations of VR for the business environment?

'Yes. We're still in the early stages. A lot of studies have used VR as a training tool. We want to move beyond that and use it as an actual mechanism to deliver certain audit procedures. And, if it can replace face-to-face interactions, it can have far-reaching benefits in the realm of, for example, reduced travel time, smaller carbon footprints and reduced stress due to jet lag. Due to the COVID-19 crisis, the majority of global companies moved to required or encouraged remote work. So, our research is not only theoretical but highly related to reality. Companies, and the old guard at companies who have been very resistant to the idea of remote work, are being slowly persuaded that remote work can be effective. Younger generations have been demanding this flexibility for a long time. It may finally be the case that those in charge are seeing the value because they have been forced to see that value.'

Okay, let's now talk about your FAR-project 'The effects of expert status on the audit of complex estimates'. What is it about?

'The project starts from a broad premise: the way expertise is assessed is fundamentally incorrect. You cannot know what an expert knows or how good they are at what they do, because they are experts. Their knowledge is unobservable to you. We tend to use heuristics, rules of thumb. Those rules of thumb are often wrong. We tend to base our views on how smart someone is on whether they are on TV or not. Or on whether they are confident: if they are confident, they must be smart. Those things are often true, but they are also often untrue. This connects back to auditing, because an important part of the audit of complex estimates is the use of experts. The auditor may not know what the value of a petroleum reserve is, since an accountant is not an engineer. So, they have to bring in an expert. Regulators are concerned that auditors are relying on experts too willingly, without delving deeper into the underlying quality of the expert work. Our idea is that the auditors might confuse status signals with substantive expertise.'

How do you study this?

'We started with the literature and summarized characteristics that are associated with status and knowledge, which are often connected. If you went to a good university that could mean that you possess both high-status and high-knowledge. However, we wanted to find indicators that represented more status and *less* knowledge. We surveyed 53 practicing auditors and asked them to rate a variety of attributes. For example, if a person plays tennis with firm leaders, how does that influence your perspective of their knowledge and how does that influence your perspective of their social status? We found those attributes that were rated by

auditors as being relatively predictive of status but less predictive of knowledge. After that, we used to survey results to conduct an experiment in which we actively manipulate what auditors see when they are auditing a complex estimate and they receive an expert's report. One half received a report from an auditor with a good amount of knowledge and experience. The other half also received a report from an auditor with a good amount of knowledge and experience, but additionally received information that they were a member of social organizations that are attended by prominent politicians, and play tennis with firm leaders – things that shouldn't be predictive of knowledge, but are predictive of status. Our idea is that auditors will rely on those cues and confuse them with genuine expertise.

We created a case concerning the audit of an investment property, based on input from practitioners. Particularly focused on the consideration of the discount rate used to value an asset.

We varied what the expert said with three different memos. In one version the expert agreed with the client and provided strong justification. That was the base line in which status shouldn't matter. Second, there was the situation that the expert agreed with the client but gave poor justification. In this case, the auditor should be questioning what the expert does. The third version is where the expert disagrees with the client estimate. We expected that the auditors would be more willing to go along with the high-status expert who disagrees. On the other hand, if the expert provided poor justification, the auditor would also be more willing to go along with the high-status specialist.

So, all participants experienced only one expert status description and one specialist memo.'

What were the main findings?

'We found that the auditors actually did disagree with the client when the high-status expert disagreed. This is encouraging. We also found that the auditors did not go along with the high-status expert when the expert agreed with the client but didn't provide a good argument for their agreement. So, auditors were using the status cue as a way to disagree with the client and not really to agree with the client more than they should.'

But you also find that auditors still use the status in their judgments?

'This is fascinating. We asked participants to assess the competence of the expert. We find that they unintentionally confuse status with competence. But, in relying on the expert when evaluating the estimate, they do know that they are relying on status, although they know status doesn't equal competence. This gets back to social issues. The social dynamics of the auditing process, the negotiations, the power imbalances that result from the audit of a complex estimate, are such that if you are going to walk into a room and tell an audit client that they need to adjust an estimate that has a material effect on their financial statements, it is not enough to have expertise, you should be able to persuade them to change. Auditors know that competence and status are not always the same thing, but they also seem to know that competence isn't enough. We say in the study that when a firm writes policies, or when standards are made, it might be helpful to consider attributes of this process that go beyond competence. Clearly, auditors don't believe competence is the only thing that is important.'

What additional attributes would you suggest?

'The one we suggest in the paper is influence within the firm. If a person has a more powerful social network, for example an expert, generally it becomes easier to tell the audit team to stand up to the client. This 'smoothes the waters'. Social status allows someone to do that.'

For more information concerning the project, please refer to:

<https://foundationforauditingresearch.org/en/news/far-working-paper-does-status-equal-substance-the-effects-of-specialist-social-status-on-auditor-assessments-of-complex-estimates/>

The Foundation for Auditing Research (FAR) is an autonomous research institute that is focused on developing and disseminating scientific knowledge concerning audit quality. FAR pursues these objectives by facilitating relevant and rigorous academic audit research via collaboration between academia and audit practice