PRACTITIONER SUMMARY

Auditors’ Use of Formal Advice from Internal Firm Subject Matter Experts: The Impact of Advice Quality and Advice Awareness on Auditors’ Judgments

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SUMMARY: When subject matter experts are consulted during an audit, the quality of the expert’s advice depends upon their ability to fully understand and incorporate client-specific facts into their advice. PCAOB inspection reports suggest that auditors are neglecting to perform the required work to assess the quality of experts’ recommendations. This article summarizes a recent study by Wright and Bhattacharjee (2018) examining how receiving expert advice of different levels of quality and the timing of communication making auditors aware of the eventual use an expert, impact auditors’ judgments. Auditors who were aware that an expert was going to be used put forth more effort before receiving the expert’s advice, and were less in agreement with management’s position, than auditors who were unaware. Upon receiving the advice, aware auditors were more discerning and accurate than unaware auditors, providing that the timing and communication of consulting decisions affect auditors’ assessments of expert advice.

Keywords: auditor advice taking; subject matter experts; advice quality; audit planning.

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Editor’s note: Accepted by Lisa Milici Gaynor.

Submitted: December 2019
Accepted: May 2020
Published Online: May 2020
I. INTRODUCTION

This article summarizes a recent study titled “Auditors’ Use of Formal Advice from Internal Firm Subject Matter Experts: The Impact of Advice Quality and Advice Awareness on Auditors’ Judgments (Wright and Bhattacharjee 2018). Specifically, we discuss the study’s motivation and hypotheses, research method, and results. We then discuss the practical implications of the study for audit firms and potential areas of future research.

II. MOTIVATION

Recent PCAOB standard adoptions strongly encourage the use of specialists, particularly when focusing on the auditing areas of fair value and estimates (PCAOB 2018a). The standards also focus on how and when to use specialists in a financial statement audit (PCAOB 2018b).¹ A key psychological process that occurs during the use of experts is the act of advice-giving by the experts and advice-taking by the audit team. Advice that subject matter experts provide to core audit teams regarding a given transaction is then incorporated into the audit evidence and is used to make decisions regarding the accounting treatment of a transaction.² Since this advice is based on information provided by management and discussions with the core audit team, the advice can vary in its quality depending on how involved the expert is with the audit. Specifically, even though subject matter experts are knowledgeable experts in their area, if they do not use all appropriate client-specific facts when assessing the issue, their advice may be of poor quality. Consequently, standards require auditors to assess the quality of the advice from subject matter experts (AICPA 2006). However, PCAOB inspections and interviews with auditors indicate that when audit teams incorporate advice from experts, they often do not perform the required work around the experts’ assessment to ensure it is accurate (Church and Shefchik 2012; Griffith, Hammersley, and Kadous 2015a). For example, inspection reports note how one audit firm’s “internal valuation specialists developed independent expectations ... depending on a significant assumption that was not supported by audit evidence” (PCAOB 2013) and comment on “the failure to test the completeness and accuracy” of issuer-provided data used by a specialist (PCAOB 2012). This overreliance on advice is consistent with findings in psychology research demonstrating that advisees are often unable to discern between the quality of superior and inferior advice (Bonaccio and Dalal 2006).

Wright and Bhattacharjee (2018) explore how characteristics of the audit process can impede auditors’ ability to discern the quality of formal advice from experts and impact their audit

¹ Audit teams receive advice from different types of experts. The first type of expert is the specialist. The use of specialists by audit teams is governed by AU-C 620, Using the Work of a Specialist, which defines a specialist as an individual with expertise in a field outside of accounting or auditing (AICPA 2012). The second type of expert is the technical expert within the field of accounting or auditing. These individuals are defined as “subject matter experts.” Subject matter experts are routinely used by audit teams for financial statement audits, and hence the focus of this study is on advice received from subject matter experts. Auditors are required to assess the quality of advice prior to accepting it into their final decisions (AICPA 2006, 2012). The standards indicate that if the audit team uses a specialist or subject matter expert, the audit team is required to ensure that the assumptions and facts used by these technical experts/specialists are appropriate and consistent with the audit team’s understanding of the client’s facts and the work performed by the team on other aspects of the audit. This study focuses on the conditions under which auditors increase their assessment of expert advice when subject matter experts are used during the audit.

² “Core audit team” is defined in the study as the members of the engagement team who are performing the majority of the fieldwork and are in contact with the client.
judgments in terms of accepting an aggressive management position. Specifically, the study examines whether certain staffing decisions made during audit planning (i.e., superiors making team members aware that a subject matter expert is ultimately going to be consulted) impacts auditors’ level of effort and thus their pre-advice assessment. The study then explores auditors’ behavior upon receiving lower- or higher-quality advice from the expert to determine whether the prior awareness impacts the final judgment based on the advice.

**Prior Awareness of Use of Experts**

When experts are available, audit team leaders can make a staffing decision at any time during the audit to consult a subject matter expert and decide on whether to incorporate the advice provided (PCAOB 2015). While introducing an expert to the core team during planning makes the team aware that an expert is involved, complex issues are often not identified until the audit is underway, so the decision to staff an expert may occur later in the audit. Thus, depending on when the staffing decision is made, auditors may or may not have prior awareness that an expert will be ultimately consulted. Such prior awareness may change the amount of effort auditors decide to put forth while evaluating the client-specific facts regarding a complex issue, which, in turn, can impact how accepting auditors are of an aggressive management position.

Being aware that a party outside the audit team, like a subject matter expert, is going to be ultimately consulted may impact effort in one of two ways. Social loafing may take place whereby auditors put forth less effort to understand the issues surrounding the complex decision because they know an expert will ultimately provide the judgment (Hackman 2002; Kerr and Tindale 2004). Alternatively, social facilitation may occur whereby the presence of others encourages an individual to put forth greater effort due to the potential evaluation of the individual’s contribution, even when working in a group (e.g., Smith, Kerr, Markus, and Stasson 2001). Psychology research indicates that social facilitation is more likely when team members perform different important tasks, a party outside the group gets involved (e.g., a subject matter expert), and if they perceive that their performance will be salient to the group (Lount and Phillips 2007; Lount and Wilk 2014). Since these conditions are prevalent when audit teams consult experts, social facilitation (as opposed to loafing) is expected to occur.

The study proposes that due to a social facilitation effect, auditors who are aware will want to be prepared to answer questions from the expert and, thus, will put forth a greater level of effort in understanding the issues around a complex transaction than those who are unaware. This higher level of effort will increase the understanding of client issues and cause aware auditors to be less accepting of an aggressive management position at the pre-advice stage than auditors who are unaware. H1 and H2 are as follows:

**H1:** Auditors who are unaware that a subject matter expert will provide advice will put forth less effort when arriving at their initial decision when compared with auditors who are aware that a subject matter expert will be consulted.

**H2:** Auditors who are unaware that a subject matter expert will provide advice will have an initial audit assessment that is more in agreement with an aggressive management’s position compared to auditors who are aware that a subject matter expert will provide advice.

**Prior Awareness and Advice Quality**

The level of effort and understanding of the client’s facts during the pre-advice assessment is expected to subsequently impact auditors’ judgments when they are provided with expert advice of
varying accuracy. Since auditors who are unaware will expend lower levels of effort during their pre-advice assessment, they are expected to be less discerning between lower- and higher-quality advice and are likely to agree with the expert, regardless of the quality of the advice. Unaware auditors will therefore be less accurate when they receive advice of lower quality and more accurate when they receive advice of higher quality. Auditors who are aware will expend greater effort to understand the issues at the pre-advice stage and are likely to better discern the quality of advice received. They will recognize the lower-quality advice and choose not to accept it, instead using their original assessment, which is expected to be more accurate. Conversely, auditors will recognize and accept the higher-quality advice. Thus, there will be a smaller difference in accuracy between the aware groups receiving lower-quality and higher-quality advice, with both groups generally being more accurate. H3 is as follows:

**H3:** There will be a larger difference in accuracy between auditors who are provided lower-quality advice and those who are provided higher-quality advice when auditors are unaware of the use of an expert before receiving the advice than when they are aware.

### III. METHOD

The study’s hypotheses were tested in an experiment where 77 professional auditors, with an average of 40 months of audit experience, were recruited from Big 4 and other large public accounting firms to participate in the study. Audit seniors are the appropriate pool of participants because auditors at this rank would be the first to assess a complex accounting issue and would be the point of contact with a subject matter expert. Prior research indicates that auditors at the senior level are often involved in interacting with experts and evaluating assumptions related to complex estimates (Joe, Vandervelde, and Wu 2017; Griffith, Hammersley, Kadous, and Young 2015b). A two-stage audit scenario was utilized where auditors read client details and assessed management’s position around a complex issue, received advice from an internal subject matter expert, and then made a revenue recognition recommendation to their audit team. In the first stage, participants were provided with the client’s background information and with information on the revenue recognition issue and then asked to provide their initial assessment of management’s position. The revenue recognition issue related to a new product manufactured and sold by the client during the current fiscal year. Unlike other products sold by the client, this product is a multiple element sale that includes a hardware piece, software package, and an optional maintenance plan. Before the details of the issue were presented, the awareness of the use of a subject matter expert was manipulated. In the aware condition, auditors were told prior to the initial assessment of management’s position that a subject matter expert would be ultimately assisting the audit team on the issue. In the unaware condition, no information on the eventual use of a subject matter expert was provided.

Participants were presented with management’s revenue recognition position. Management’s position was that they had performed all the required services relating to the three identified accounting units and therefore they recognized the total amount of year-end revenue as $15,017,940. Participants were then asked to provide their assessment of management’s position by stating the amount of year-end revenue that should be recognized (pre-advice assessment) based on the client background information, specific issue facts, and the applicable guidance. Participants also were asked to justify their assessment of management’s position.

In the second stage, auditors were provided with the expert’s advice. Participants were first informed or reminded (depending on the awareness condition) that a subject matter expert
provided advice, and were informed that, per professional standards, the audit team is ultimately responsible for assessing the advice quality. The case indicated that the advice was provided as a memo from a revenue recognition subject matter expert team manager. The memo first outlined the client-specific facts as understood by the subject matter expert. All participants were reminded that the audit team would be ultimately responsible for assessing the information provided to the expert. The memo then discussed the expert’s analysis of the issue and their understanding and agreement with management’s position. This is where the quality variable (higher-quality or lower-quality advice) was manipulated.

In the higher-quality condition, the advice was accurate. The appropriate accounting treatment identifies three units of accounting (hardware, software package, and maintenance plan). Based on the client-specific facts, the hardware revenue should be recognized immediately, while both the software package and maintenance plan revenue should be recognized over the 24-month service period. The higher-quality advice incorporated all the client-specific facts and applied the accounting guidance appropriately, agreeing with management that the hardware revenue can be recognized immediately, but indicated that the software package and maintenance plan revenue should be recognized over the 24 month service period. The explicit recommendation of revenue provided by the higher-quality advice ($10,660,545) was therefore substantially lower than management’s position ($15,017,940).

In the lower-quality advice condition, the expert omitted an important fact related to the software package that would identify the software package as an independent accounting unit whose revenue should be recognized over the 24-month service period. The lower-quality advice agreed with management’s position on the separate accounting units and the position that the revenue for the hardware and software package could be recognized immediately. Although the lower-quality advice omitted the fact about the software length of service, the advice disagreed with management regarding the maintenance plan. Thus, the recommended amount of revenue in the lower-quality condition ($12,277,440) was lower than management’s position ($15,017,940), but still higher than that recommended in the higher-quality condition ($10,660,545).

Thereafter, auditors listed their recommendation of the amount of year-end revenue that should be recognized (post-advice recommendation). Participants were also asked to provide justification for their decision and detail how they utilized the advice from the expert.

IV. RESULTS

The study measured the time spent by participants to assess the level of effort employed. The results indicate that auditors who were in the aware condition expended more effort by spending more time to complete the pre-advice task (mean = 25.63 minutes) than auditors who were in the unaware condition (mean = 20.74 minutes). This supports H1 since being aware led to auditors putting forth a greater level of effort in understanding the issues than being unaware.

The agreement of auditors’ pre-advice assessment with management’s position was measured as the difference between management’s position and a participant’s pre-advice assessment. Results show that, while both groups took a position that was more conservative than management’s position, the aware group was more conservative in their pre-advice assessment (mean difference = $4,169,535) and further from management’s position than the unaware group (mean difference = $2,860,087), supporting H2.

Auditors’ documentation to justify their pre-advice decisions was analyzed. Auditors in the aware group documented more unique key factors and noted more items disagreeing with
management’s position (mean = 7.09 and mean = 2.29, respectively) than those in the unaware condition (mean = 5.79 and mean = 1.91, respectively), further supporting H1.

At the post-advice stage, results indicate a larger difference in accuracy between auditors who were provided lower-quality versus higher-quality advice when they were unaware as compared to when auditors were aware. The lower levels of effort expended during the pre-advice assessment made the unaware auditors less able to discern between lower- and higher-quality advice, supporting H3. The aware conditions documented more unique key factors as justification for their post-advice recommendation than the unaware conditions in the post-advice stage, with both the lower-quality advice (mean = 5.94 and 3.43, respectively), and the higher-quality advice (mean = 5.61 and 4.05, respectively). Therefore, the aware conditions utilized more key factors in their assessment of the issue as well as in their assessment of the advice provided, allowing them to better grasp the information that was important to the assessment and to judge whether to question the advice. Figure 1 displays the results of accuracy in the post-advice recommendation for each condition.

Additional analyses clarified the process by which prior awareness influenced judgments at the pre- and post-advice stages. Relative to being unaware, being aware increased the level of effort expended to understand the issues at the pre-advice stage. As auditors spent more effort understanding the issues at the pre-advice stage, they agreed less with management’s position.

**FIGURE 1**

Interaction between Awareness Timing and Advice Quality on Accuracy

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Accuracy is calculated as the difference between the auditor’s final judgment and the accurate amount of revenue to be recognized. Note that the smaller the accuracy score the more accurate the final judgment.
Finally, a negative relationship between pre-advice disagreement with management and post-advice accuracy was observed, with greater pre-advice disagreement with management’s position leading to higher accuracy.

Data were gathered in a second experiment to rule out the alternative explanation that participants in the aware groups may have been given an implicit signal that the revenue recognition issue was particularly significant to the audit. The overall findings of the second experiment were the same as those in the main experiment. Furthermore, results indicated no differences between the aware and unaware conditions in auditors’ perceptions of the level of risk and level of complexity of the revenue recognition task or the level of significance that auditors felt that the engagement partner had placed on the revenue recognition task. These results help to rule out the alternative explanation that the results were due to the aware conditions perceiving the task as being more risky and important than the unaware conditions.

V. SUMMARY AND PRACTICAL IMPLICATIONS

Audit engagement staffing is an important component of monitoring and enhancing audit quality and can impact the subsequent testing and evaluation of evidence (EY 2014). This study examines how a staffing decision about whether superiors make audit team members aware during audit planning of the eventual use of an internal subject matter expert, and the quality of advice received from the expert, can influence auditors’ ability to discern the quality of advice. Due to a social facilitation effect, auditors in the prior aware condition expended more effort on the task, documented more key client facts at the pre-advice stage, and, consequently, took a pre-advice position less in line with management’s aggressive position as compared to auditors who were unaware. Upon receiving higher-quality advice, auditors’ recommendations were consistent with the advice, regardless of whether they were aware or unaware. However, when auditors received lower-quality advice, auditors in the unaware conditions tended to gravitate toward the lower-quality advice. However, auditors in the aware conditions were more discerning of the advice and took a final position closer to the higher-quality advice rather than the lower-quality advice they actually received. Therefore, the benefits of prior awareness persisted even after auditors in all groups received the expert advice.

This study’s findings should interest practitioners by advancing their understanding about how knowledge of planned audit procedures and the resulting staffing decisions can affect auditors’ assessment of advice from experts. Our results demonstrate that the audit effort of lower-level members of the audit team can be increased by explicitly communicating the decision to utilize an expert. Lower-level auditors who are made aware early in the audit of the eventual use of an expert expend more effort to understand the accounting issues with which the expert is involved, independent of the expert’s contributions to the audit. These findings highlight a low-cost way in which auditors can be induced to first assess the accounting decisions made by management and then appropriately evaluate the quality of the expert advice.

In light of these findings, firm management or regulators can consider explicit documentation and communication guidelines on the timing of expert involvement during an audit. Such requirements should span the entire audit team, since multiple team members play a part in the detail testing of the support provided by management on an accounting issue. Firms could also consider establishing deadlines for planned expert involvement during an audit and include time in budgets clearly delineating the time team members who receive expert advice can spend appropriately evaluating how management is accounting for an accounting issue, making a reasonable pre-assessment of that issue, and finally assessing the advice quality. Furthermore,
subject matter experts may not consistently provide superior advice in complex situations such as Level 3 fair value analysis, going concern analysis, and inventory obsolescence valuation. Audit firms and regulators should consider educating auditors of this fact and recommend auditors to be diligent in assessment of the advice quality for all complex transactions.

Given the recent push by PCAOB standards encouraging the use of specialists, the findings of Wright and Bhattacharjee (2018) should spur more research on how specialists’ advice is used by audit teams. Since time budgets are ubiquitous during audit engagements, research can examine if time pressure impacts the weighing of advice from specialists. When auditors receive advice from specialists, they may receive advice on the same issue from other sources (e.g., team members). Research can examine how auditors’ weight advice from multiple sources, especially if they are contradictory. Research can also examine how formal audit firm policies can assist in assessing the quality of advice and whether steps to increase professional skepticism also can help auditors become more discerning of advice received from specialists.

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