Research Article

A Study of Auditors' Judgement When Taking Management's Perspective on Management Discussion and Analysis*

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ABSTRACT

This experimental research examines the effect of management's perspective on auditors' judgment when they review management discussion and analysis (MD&A). This study predicts that prompting management's perspective would benefit auditors by enabling them to more accurately review MD&A whether or not the MD&A is materially misstated. Contrary to our expectations, prompting auditors with a management's perspective will backfire. The results find that auditors prompted by management's perspective are significantly more likely to accept MD&A that has an abnormally positive tone. In other words, auditors are less likely to ask management to alter MD&A that has such abnormally positive language. Management's perspective will trigger auditors' pre-existing motivation, making them much more likely to maintain a good relationship with clients to justify a management-preferred conclusion. This study expands the understanding of taking management's perspective could influence auditors' judgement when reviewing MD&A. Moreover, the findings of this study highlight the potential bias that comes from prompting auditors to take a management's perspective.

Keywords: Management Discussion and Analysis, Perspective Taking, Motivated Reasoning

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บทความวิจัย

การศึกษาดุลยพินิจของผู้สอบบัญชีเมื่อใช้มุมมองของผู้บริหารต่อคำอธิบายและวิเคราะห์ของฝ่ายจัดการ*

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บทคัดย่อ

การวิจัยเชิงทดลองนี้ศึกษาผลกระทบจากมุมมองของฝ่ายบริหารที่มีต่อการตัดสินใจของผู้สอบบัญชีในการสอบทานคำอธิบายและการวิเคราะห์ของฝ่ายบริหาร การศึกษานี้คาดการณ์ว่า การกระตุ้นมุมมองของฝ่ายบริหารจะเป็นประโยชน์ต่อผู้สอบบัญชี โดยช่วยให้พวกเขาสามารถตรวจสอบคำอธิบายและการวิเคราะห์ของฝ่ายบริหารได้แม่นยำยิ่งขึ้นว่าคำอธิบายและการวิเคราะห์ของฝ่ายบริหารผิดในสาระสำคัญหรือไม่ ตรงกันข้ามกับการคาดการณ์ของเรา การกระตุ้นมุมมองของฝ่ายบริหารต่อผู้สอบบัญชีส่งผลตรงข้ามกับที่ตั้งใจไว้ ผลการวิจัยพบว่า ผู้สอบบัญชีที่ได้รับการกระตุ้นจากมุมมองของผู้บริหารมีแนวโน้มที่จะยอมรับต่อคำอธิบายและวิเคราะห์ของฝ่ายจัดการที่มีลักษณะเชิงบวกที่ผิดปกติอย่างมีนัยสำคัญ กล่าวอีกนัยหนึ่งคือ ผู้สอบบัญชีมีแนวโน้มน้อยที่จะร้องขอให้ฝ่ายบริหารเปลี่ยนแปลงคำอธิบายและวิเคราะห์ของฝ่ายจัดการ การกระตุ้นมุมมองของฝ่ายบริหารกลับไปกระตุ้นแรงจูงใจที่มีอยู่แล้วของผู้สอบบัญชีให้พวกเขามีแนวโน้มที่จะรักษาความสัมพันธ์ที่ดีกับลูกค้าโดยให้การสนับสนุนตามข้อสรุปที่ฝ่ายบริหารต้องการ ผลการศึกษานี้เพิ่มความเข้าใจเกี่ยวกับการได้รับการกระตุ้นจากมุมมองของฝ่ายบริหารมีอิทธิพลต่อการตัดสินของผู้สอบบัญชีเมื่อสอบทานคำอธิบายและวิเคราะห์ของฝ่ายจัดการ นอกจากนี้ ผลของการศึกษาเน้นให้เห็นถึงอคติที่อาจเกิดขึ้นซึ่งมาจากการกระตุ้นให้ผู้สอบบัญชีพิจารณามุมมองของฝ่ายบริหาร

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1. Introduction

The item 303 of Regulation S-K by the Securities and Exchanges Commission of the US (SEC) mandates that Management Discussion and Analysis (MD&A) is to be included in a public company's annual and quarterly report for shareholders in order to provide the results of operation, trends related to liquidity, critical accounting estimates, contractual obligations, off balance sheet arrangements, and other information that is not captured in financial statements. This is of course another way of presenting the information considered to be useful since it shows not only forward-looking orientation about trends and risks that could affect the current and future financial statements, but also explanation of the management's strategy in order to achieve both short- and long-term objectives of a company (SEC, 2003).

Although the main objective of MD&A is to reduce the information asymmetry between managers and stakeholders and to be a valuable source of information for the stakeholders, including investors therein (Cohen et al., 2008; Li, 2010), there still exists an ample controversy over the informativeness of the MD&A. Indeed, the informativeness of the MD&A could be impaired by management's discretion in the way that the management could demonstrate an organization's information in a way favorable to the preference of the management. It is within the possibilities that the management, for an instance, would be using a more positive linguistic tone or more forward-looking analysis when discussing the firm's performance (Huang et al., 2013). To summarize, managers have an opportunity for strategic reporting with the utility of the tone of the MD&A in an attempt to reduce the negative market reaction (Davis & Tama-Sweet, 2012; Huang et al., 2013).

Even though the MD&A is not audited by an auditor, evidence in the literature supports that both professional and nonprofessional investors enhance and prefer to use the information content in the MD&A provided by the management (Hodge & Pronk 2006; Rowbottom & Lymer, 2010; Arnold et al., 2011b). As a result, if there is a significant misstatement in the MD&A, the investors could make a wrong decision, and this would incur a huge loss in the economy. To improve the MD&A quality, Cohen et al., (2008) suggest that auditors can play the role in enhancing the quality of the MD&A disclosure by analyzing and reviewing it. The International Auditing and Assurance Standards Board (IAASB) issued the International Standards on Auditing (ISA) 720 (revised), The Auditor's Responsibilities Relating to Other Information, that identifies the scope of an auditor's responsibilities on the other information –both financial and non-financial information– to be included in a company's annual report. An auditor is not required to audit the MD&A but to read and consider the other information inconsistent with either the financial statements or the auditor's knowledge based on the obtained information while conducting the audit; this is to ensure that no materially misleading information is included for the purpose of enhancing the credibility of the financial statements[1]. If an auditor finds the material misstatement or inconsistency of such information, he/she must communicate to those charged with the audit committee; additionally, ask management to correct such misstatement or performing additional audit procedures, if necessary.

Prior studies recommend that perspective taking would bring about an understanding of another person's thoughts, attitudes and concerns in any particular situation (Epley & Dunning, 2006). This means that if the MD&A's misstatement results from the management's actions motivated by the benefit from such MD&A's misstatement, an auditor, taking perspective of a client's management would be more responsive and understand the situation that the management is trying to mislead the investors.

In an audit context, perspective taking could benefit in the setting that auditors are not engaged with management interaction such as the evaluation of financial statement misstatement. Church et al., (2015) and Hamilton (2016) shows that auditors taking management's perspective are more likely to improve their judgement on assessing financial report misstatements and to assess the misstatement to be intentional rather than those who do not take the perspective of management. Altiero et al., (2022) nevertheless documents the opposite findings as presenting that the investor-prompted auditors would decrease the likelihood that they will consider audit adjustments to be material due to pre-existing motivations of the auditors that tend to justify a management-preferred conclusion.

Having been aforementioned, the findings from the experiment by Altiero et al., (2022) contradict those that inspire this study in that an auditor's perspective taking is not always, or necessarily, presented by showing more of the expected actions, that is, an increase in the likelihood to consider transactions to be material in favor of an investor's intention despite the fact that they gain some target's insights from taking such perspective. This is because the auditor perceives that if he makes judgements in favor of an investor's intention, he would be threatened by management's preferences. As reviewed by Bhaskar et al., (2019), auditors with directional preferences are more likely to favor their clients in various audit environments while making correction decisions. In summary, taking the perspective of someone's could be more likely to backfire than to be effective in certain situations. This argument inevitably raises another question whether auditors decide differently between performing tasks that interact with and do not interact with management when they take management's perspective. Another thing to note here is that previous literature documents that within the assessment task, without management's interactions, an auditor would perform better. (Church

[1] A review of an MD&A presentation for an annual period, an interim period, or a combined annual and interim period.

et al., 2015 and Hamilton, 2016); meanwhile, There have, up until present, been no studies on the investigation of an auditor in the correction task, in which there are management's interactions; this is the reason why this study shall conduct such investigation to fulfil the loophole. Our experimental study allows us to understand how perspective taking as management affects the auditors' judgment while making assessment and correction decisions.

This study conducted a 1×2 between-subjects experimental design with 80 audit managers from one of the Big 4 audit firms. Participants were assumed to be audit managers of a hypothetical audit firm who were responsible for reviewing MD&A based on the provided information. We constantly held background information, an annual financial statement with selected financial information, and an abnormally positive tone MD&A. We manipulated perspective taking either prompted or unprompted management's perspective as an independent variable. Participants later answered post-experimental questions regarding how they individually considered the positive and negative consequences of reviewing the MD&A.

The results are not consistent with the assessment decision hypothesis; however, the correction decision hypothesis is consistent. We find that auditors who are prompted with a management's perspective are more likely to indicate that MD&A reflect the current stage of the company and have a less positive tone in an assessment decision than auditors who are not prompted by management's perspective. Furthermore, compared to auditors who are not prompted by management's perspective, auditors with a management's perspective are more likely to not request the management alter the MD&A. These results suggest that prompting management's perspective makes auditors more accepting such aggressive MD&A. For these reasons, prompting management's perspective triggers auditors' client-preferred directional goals, which will make auditors intensify their propensity to rationalize management-preferred conclusions in both assessment and correction decisions (Ng & Shankar, 2010; Guiral et al., 2011; Kadous et al., 2013). Moreover, we find that client relationships partially mediate the effect of perspective taking on auditors' correction decisions.

For academics and practitioners alike, this study offers a number of contributions. First and foremost, our theory and findings extend prior accounting studies. This study, in contrast to earlier studies (Church et al., 2015; Hamilton, 2016), finds evidence that prompting auditors to take a management's perspective causes them to justify their conclusion with a management's preferred conclusion. In other words, prompting auditors backfired in our studies, causing auditors to less heavily weight the fact that MD&A contains an abnormally positive tone, resulting in clients not being requested to alter the abnormally positive tone MD&A.

Second, we provide evidence that management’s perspective triggers auditors pre-existing motivation by making them consider maintaining client relationship. Prior auditing research suggests that auditors are more likely to support client-preferred aggressive accounting treatment when the relationship between the auditors and clients is close and highly in good terms (Koch & Salterio, 2017). The result indicates that the effect of perspective taking on auditors’ correction decision is partially explained by auditors ‘consideration to maintain client relationship.

The third contribution can be deemed as an extension to the literature of MD&A. This illustration of auditors’ judgement bias toward client’s preference from this study would shed some light on the limitation of using perspective-taking for auditors. Even though auditors perceive and gain insight in favor of the personal benefit of the management, they are more likely to support the management's preferred conclusion. Thus, our study should be of interest to regulators and standard-setting bodies that have emphasized the importance of information disclosed to the public.

Our remaining paper is organized as follows. Section 2 includes the theoretical development of our hypotheses. Section 3 describes our research design. Section 4 reports the results of our test and additional analyses. We conclude and discuss implications in Section 5.

2. Literature Review and Hypothesis Development

2.1 Definition and Implications of Management’s Discussion and Analysis

Most regulations and accounting standards across the world—United State Code of Regulation S-K (2010, Section 299.303), Canadian National Instrument 51 (2004, Section 102) and International Financial Reporting Standards, to name but a few—require the management of registered and publicly-traded firms to include narrative disclosure, which is called Management’s Discussion and Analysis (MD&A) in their annual and quarterly reports (Li, 2017). According to Item 303 of Regulation S-K by the Securities and Exchange Commission (SEC), the MD&A should provide the discussion of liquidity and capital resources, results of operations, off-balance sheet arrangements, critical accounting estimates, significant contractual obligations, and other materials and relevant information that are not captured in the financial statements. The MD&A should enhance understanding of the factors influencing a company’s performance and convey management’s qualitative and interpretive insights applicable to the firm’s performance (Bagby et al., 1988). In addition, MD&A help to reduce the information asymmetry between managers and the market (Cohen et al., 2008, Li, 2010).

2.2 Tone Management in the Management Discussion and Analysis

Not only are the management or discretionary accruals known as a tool to manipulate investors' perceptions of a company but tone management is also an alternative or complementary tool to influence investors' impression of a firm (Huang et al., 2013, Toeh et al., 1998; Xie, 2001). To elaborate on this, the tone of qualitative text can be a tool for managers either to improve their understanding of, or to vaguely define, company fundamentals (Huang et al., 2013). In sum, this capacity can be used for good or bad purposes; it can cause great benefits as well as great harm.

Although the regulations and standards require MD&A to be included in annual and quarterly reports for public entities with specific components of information, the information content and format are deliberately unstructured (Bagby et al., 1988; Bryan, 1997; Cohen et al., 2008). For this reason, according to Brown & Tucker (2011), standards offer specific guidance, but they also give managers the freedom to tailor the level of detail provided and the language used in MD&A to meet particular company and industry trends and needs that have an impact on their bottom line. Thus, a manager may compromise the accuracy of MD&A by not only engaging in selective disclosure to influence a stakeholder's perception and decision, but also by omitting, misrepresenting, or even withholding negative information. This inevitably creates information asymmetry (Arslan-Ayaydin et al., 2016; Cohen et al., 2008; Huang et al., 2013; Kothari et al., 2009; Meiers, 2006; Schleicher & Walker, 2010; Verrecchia, 2001).

As demonstrated in previous research, managers can use the tone of language in the MD&A as an opportunistic strategy to mislead investors. To explain such opportunistic behavior, it is worthwhile considering the study by Davis & Tama-Sweet (2012), positing that the managers can utilize tones of the language across alternative disclosure outlets between press release and MD&A with the motive of managers' incentive to report strategically. Their findings show that managers who are more concerned with the effects of information disclosure on stock prices are more motivated to report strategically by elevating the proportion of upbeat language and lowering the proportion of all pessimistic language in their earnings press releases relative to the MD&A in order to elicit favorable market reactions.

The study by Huang et al., (2013) explores whether the utilized tone of language informs or misinforms investors. According to their research, an overly upbeat tone indicates that future performance would be poor, which may indicate that the manager is trying to mislead investors. Additionally, managers opportunistically manage more positive tone due to incentives derived from either their desire to achieve a certain level of prestige or economic motives, which are frequently linked to agency problems, such as the motivation to raise stock prices, meet or beat analysts' forecasts, or even conceal their subpar operating performance. It is, thus, irrefutable to purport the viewpoint that an abnormally positive tone is associated with the presence of strategic incentives and misleads investors.

To summarize, the tone of language used in the MD&A conveys incremental information content that affects the company's information and inexorably adds to financial information provided to investors. Nonetheless, under the guise of incentives to manage the tone of MD&A, opportunistic managers have a tendency to proceed with an impressive management strategy by using more optimistic and future-focused language to deceive investors and trigger favorable market reactions when the company is confronted with a financial condition problem (Caserio et al., 2019).

2.3 International Standards on Auditing (ISA) 720 (revised)[2]

The ISA 720 (Revised) states that in order to provide transparency and the credibility of financial statements, auditors are not required to audit and provide assurance on other information included in a company's annual report. Instead, they are encouraged to read and take into account any other information that is materially inconsistent with the financial statements. Whether the other information is acquired by the auditor before or after the date of the auditor's report, the auditor's obligations connected to it still apply. The credibility of the financial statements and the auditor's reports may be weakened by such a material misstatement of the other information. Moreover, material misstatement is also likely to lead to inappropriate influence over the economic decisions of the users for whom the auditor's report is prepared (Cohen et al., 2008). When the auditor concludes that the other information is materially misstated, the auditor has to request the management to correct the other information. If management does not correct, the auditor must communicate the matter to the parties charged with governance. To summarize, the ISA 720 (Revised) outlines the auditor's duties in relation to examining the other information as reading, considering, and reporting that there is no material misstatement, but not assuring the accuracy of the other information.

[2] The concept of International Standards on Auditing (ISA) 720 (revised) and Statement on Auditing Standards (SAS) No. 137 is closely similar in both auditing standards.

2.4 The Effect of Perspective Taking and Auditors' Assessment and Correction Decision

Perspective taking can be defined as the ability to entertain the psychological perspective of another by intuiting another person's thoughts, feelings, and inner mental states (Davis et al., 1996; Epley & Caruso, 2009; Galinsky et al., 2000). Understanding the viewpoint of the opposing side is a straightforward and efficient method for coming up with the finest solution (Epley & Dunning, 2006). For instance, Mead (1934) agrees that the ability to shift perspectives is a major development in cognitive functioning. The ability to develop perspective taking allows us to reduce egocentric bias in our judgement, to have a beneficial effect on interpersonal relations, and lastly, to understand others' expectations. Furthermore, prior study indicates that perspective taking can enhance people's judgement and decision-making (Epley & Dunning, 2006).

The existing literature and research on perspective taking state that perspective taking provides various benefits for enhancing interpersonal understanding and giving insight into the thoughts, feelings, and intentions of others (Galinsky & Moskowitz, 2000). Furthermore, Galinsky & Mussweiler (2001) support that perspective taking would help to enhance judgement and decision-making.

Perspective taking in the auditing context is conducted by Church et al., (2015) which documented that the auditors taking their role as managers also enhance their understanding in terms of a manager's viewpoint on financial reporting and benefit the auditor's performance. It is thus irrefutable that perspective taking improves an auditor's ability to precisely assess a manager's earning report. Moreover, it is also supported by Hamilton (2016), who shows in his study that the auditor who takes the perspective of the manager is more likely to assess the misstatement to be intentional than the auditor who does not during the planning phase.

Apart from the audit tasks, auditors perform different task structures for the purpose of conforming audit opinion in accordance with financial statements. Interestingly, recent literature has lent emphasis on the need for consideration of the task structures for auditors' judgement and decision-making in behavioral research (Bonner & Pennington, 1991; Nelson & Tan, 2005). According to Nelson & Tan (2005), the audit task can be classified into 4 areas: namely, (1) audit planning, together with the risk assessment and audit risk model and (2) analytical procedures and evidence evaluation (3) correction decision regarding to whether to require a client to correct a detected material misstatement, and (4) going concern judgement.

Extending from the literature on perspective taking, this study investigates the main effect of perspective taking with regard to the question of whether or not the difference between management-prompted and unprompted conditions impacts auditors' assessment decisions with an abnormally positive tone in the MD&A and auditors' correction decisions to request management alter the MD&A. According to ISA 720 (revised), even though auditors do not have to audit the MD&A, they still have responsibility for reviewing and identifying the material misstatement of the MD&A. This study posits that when auditors take management's perspective, they would obtain the benefit by means of harmonizing themselves with the management to obtain some self-interest from the management in order to gauge the management's behavior. Ultimately, this enables them to better understand the reasons behind the MD&A's abnormally positive tone and assess whether or not the MD&A is materially misstated. Therefore, it can be stated that auditors who are prompted with management perspective are not alighted with management and agree less with this management opportunistic behavior, stating low on the likelihood of the MD&A reflecting the current state of the company and high on the likelihood of the MD&A containing a positive tone while assessing the MD&A containing the abnormal positive tone. As a result of all of this, this leads to the first hypothesis.

H1a: In assessment decision, the auditors who are prompted by the management perspective are more likely to assess the likelihood of the abnormally positive tone MD&A in the manner that reflects the current state of the company at a lower state than those who are unprompted by the management perspective.

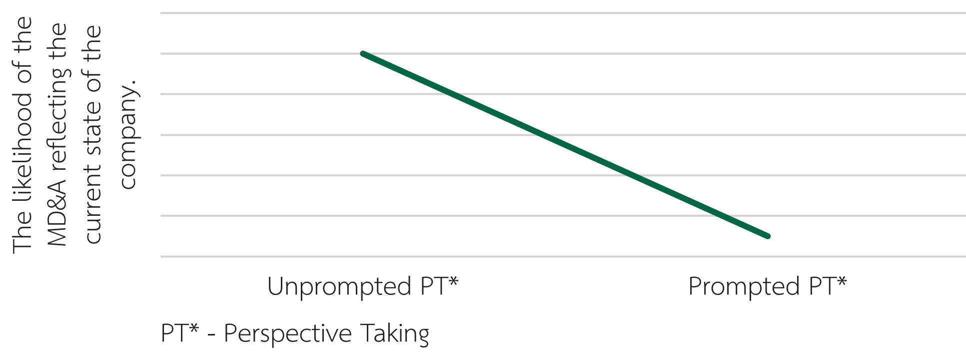

Figure 1: The prediction of the effect of perspective-takings on the likelihood of the MD&A reflecting the current state of the company

H1b: In assessment decision, the auditors who are prompted by the management perspective are more likely to assess the likelihood of the abnormally positive tone MD&A in a manner that indicates a higher positive tone than those who are unprompted by the management perspective.

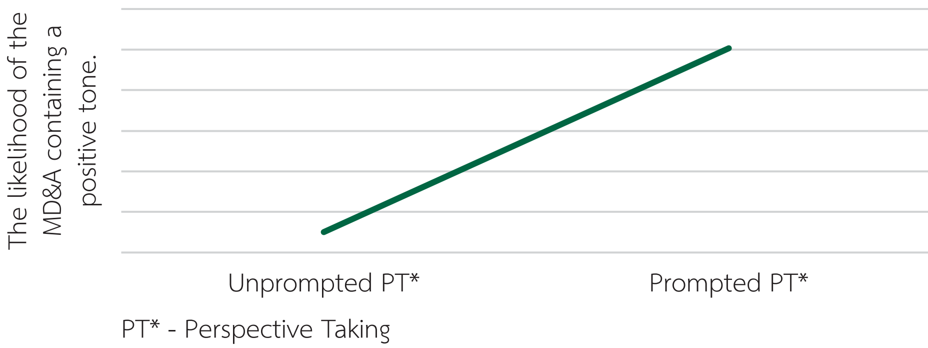

Figure 2: The prediction of the effect of perspective-takings on the likelihood of the MD&A containing a positive tone

According to H1a and H1b, auditors who are prompted by management's perspective are likely in line with management's incentive and this practice enables them to comprehend and evaluate the behavior of the management. Therefore, auditors are expected to benefit from management's perspective and be better able to access MD&A by identifying low on the likelihood of the MD&A reflecting the current state of the company and high on the likelihood of the MD&A containing a positive tone while assessing abnormally positive tone MD&A. Then, in response to this concern, they must request management to alter the MD&A's material misstatement.

Although perspective taking can have positive effects on judgment, it does not improve the capacity to make sensible decisions on behalf of targets (Eyal et al., 2018). Perspective taking literature suggests that taking one's perspective would be successful whenever the target objectivity is not in conflict with an observer's pre-existing motivation (Sassenrath et al. 2016). Recent studies support the idea that auditors with pre-existing motivations often engage in motivated reasoning by arriving at management-preferred conclusions. (Hackenbrack & Nelson, 1996; Wilks, 2002; Kadous et al., 2003; Kunda, 1990). As contributed by Bhaskar et al., (2019), such a concept can be more understandable in terms of its setting. Indeed, when the management decides to release an income statement before the audit process is complete, this management's decision would put more pressure on an auditor with directional preference to accept the management's preference for aggressive accounting treatments.

Moreover, Altiero et al. (2022) also support the idea of auditors' pre-existing motivation when prompting auditors to take investors' perspective. They nevertheless document the opposite findings from Church et al., (2015) and Hamilton (2016) when the auditors are prompted by investors' perspective. Their findings demonstrate that auditors who are prompted by investors' perspective are less likely to view audit adjustments as material since these auditors already have motivations that tend to support a management-preferred outcome. This further allows us to comprehend the bias of the auditor's judgements when prompted by the investor's perspective. The auditor could not completely step into the investor's shoes because they have already been motivated by the management's preferences. In conclusion, it is clear that such behavior significantly harms the audit profession by considerably inducing bias in the auditors' professional judgments and decision-making to be in line with management. In the context of correction decision, when auditors are prompted by management's perspective, this study posits that management's perspective allows auditors to comprehend management preferences. It will influence auditors' behavior in accordance with the motivated reasoning theory by triggering auditors' pre-existing motivation to strengthen their propensity to reach management-preferred conclusions. Thus, this study hypothesizes that:

H2: In a correction decision, the auditors who are prompted by management perspective are less likely to request that management alter the material misstatement of the MD&A than those who are unprompted by management perspective.

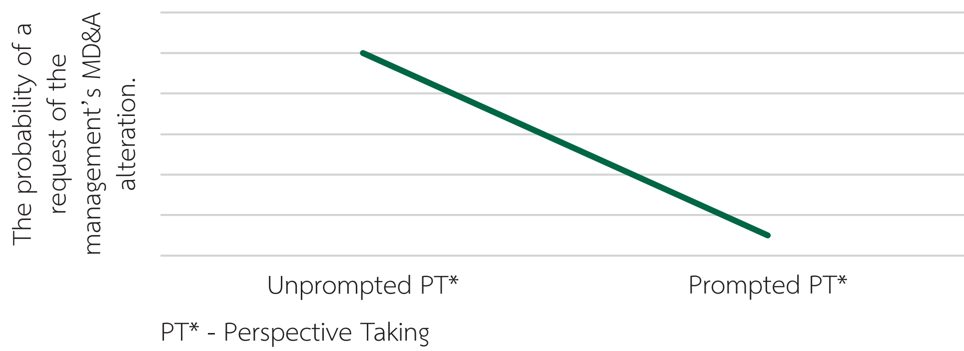

Figure 3: The prediction of the effect of perspective-takings on the probability of a request of the management's MD&A alteration

3. Methodology

3.1 Participants

This study conducted an experiment with 80 audit managers from one of the big four audit firms[3]. Targeting these positions stems from the discovery that auditors in these ranks are likewise susceptible to motivated reasoning and have a purpose in mind to arrive at any management-preferred

[3] We sent a letter of authorization to one of the Big Four audit firms before the study's data collection and experimentation got started in order to obtain permission to do so. On April 19, 2023, we did the experiment and collected the data.

conclusions while adhering to reasonableness limits (Kadous et al., 2003; Koch & Salterio, 2017). Moreover, audit managers routinely analyze the effects of an audit adjustment on the financial statements and determine what information should be recommended to the partners for the purpose of the audit adjustment (Abdolmohammadi, 1999). Therefore, it can be stated that the audit managers are well-matched to our experiment.

To ensure that participants understood the importance of MD&A and the consequences of reviewing MD&A that influence economic decisions. We tested participants' knowledges through post-experimental questions[4] after completing the main task. Participants were asked to indicate their assessments of the eight statements on an 11-point scale ranging from 0 (Strongly disagree) to 10 (Strongly disagree). The participants who obtained average scores less than the midpoint (i.e., 5) would be excluded for further analysis. Nevertheless, I excluded 10 participants whose average responses fell below the median. Overall, the participants generally had sufficient knowledge for the required task and were appropriate to be used as participants in this study. The number of participants in the analysis is shown in Table 1.

Table 1 Number of participants used for analysis

Treatment condition	A	B	Total
Total	40	40	80
Less: Low knowledge	6	4	10
Final sample	34	36	70

Abbreviation of treatment condition:

A = Prompted with management-perspective B = Unprompted with management-perspective

The participants have a mean audit work experience of 8.89 years. Fifty-six percent of participants report their experience proposing the audit adjustments during the year prior to their participation. Table 2 shows demographic information about participants.

[4] Knowledge test was developed from ISA 720 (Revised), The Auditor's Responsibilities Relating to Other Information, and reviewed by two audit partners and two audit managers from two of the big four audit firms to ensure it appropriate to use for checking participants' knowledge.

Table 2 Demographic Information (n = 70)

	Number	Percentage
Sex		
Female	51	73%
Male	19	27%
Age		
30 and below	30	43%
31–40	39	56%
More than 40	1	1%
Education		
Bachelor's Degree	61	87%
Master's Degree	9	13%

3.2 Materials

The case material[5] is organized into two parts. The first part contained management's perspective manipulation. Management's perspective would be prompted by completing management-minded tasks to facilitate the role-play manipulation.

The second part, holding constant for all conditions, is presented with the same information about the hypothetical company's background, with the economic performance and the MD&A report, which exhibits an abnormally positive tone. The company is presumed to be a listed company in the technology industry. The company's business had steadily grown over the past ten years and its stock was also traded on The Stock Exchange of Thailand (SET). Nevertheless, the company is facing fierce competition and technology change from other players in the industry. Moreover, participants are given the audit summary memorandum, provided by the audit team. The provided information would present the problem of the company's cash flow liquidity positions and many obsolete inventories on hand; meanwhile, the participants are instructed to assume the role of audit manager.

[5] We started by interviewing two audit partners and two audit managers from two of the big four audit firms to develop our case materials. The case also was reviewed by two audit partners and two audit managers in order to make sure the experimental case was realistic.

3.3 Design and Manipulation

This study employed a 1×2 between-subjects design in the two experimental conditions to test the hypotheses. Participants were assumed to be audit managers and given decision-making authority to review MD&A. They were randomly assigned to perspective taking conditions (prompted and unprompted).

According to the literature in the field of psychology, there are several ways to manipulate perspective taking, such as giving instruction in order to imagine the target's perspective (Davis et al., 1996), reading or listening to the target's story (Batson et al., 1998; Finlay & Stephan, 2000; Galinsky et al., 2008), viewing a documentary from another person's perspective (Dovidio et al., 2004). Some studies manipulate with a cognitively stronger task by asking the participants to engage with the tasks by writing an essay from another individual's perspective (Galinsky & Moskowitz, 2000; Mazzocco et al., 2012). With reference to the various methods above, the most appropriate method to be used in this study is cognitively effortful intuition because it aids auditors in stepping outside of their ingrained routines or habits (Trotman et al., 2005; Hamilton, 2016). Consequently, we manipulated perspective by including or excluding a role-play prompt to take the management perspective (management prompted and management unprompted).

Perspective taking is manipulated with prompted and unprompted views of management's perspective. First, the role-play prompt would ask participants in the prompted condition to "step yourselves into the shoes of management". Then, they are asked to answer questions about factors that would affect your decision when preparing Management Discussion and Analysis (MD&A). However, it should be highlighted that this manipulation will be excused if the management's perspective is given unprompted.

3.4 Experimental Procedures

At the beginning of the experiment, participants were informed of the purpose and required task of this study before deciding whether to participate[6]. After then, participants were randomly assigned to each treatment condition. The first envelope is case materials which contained background information, treatment conditions, and the dependent variable response sheet. After reading the case materials, participants were asked to rate how likely it was that the MD&A would represent

[6] The Research Ethics Review Committee for Research Involving Human Subjects at Chulalongkorn University rigorously scrutinized this study before it was carried out. The information was kept private, and the participants were safeguarded from harm. The risk of taking part in this study was minimal.

the company's current status, using an 11-point Likert scale ranging from 0 (not at all) to 10 (very much), and whether or not it would have a positive or negative tone, using an 11-point Likert scale ranging from -5 (extremely negative tone) to +5 (extremely positive tone) in the assessment decision. Participants were also asked to rate the probability of a request of the management's MD&A alteration, measuring on a scale of 0% (not at all requesting) to 100% (requesting the management to alter MD&A with 100% certainty), in order to make a correction decision. After completing, participants are instructed to place the case instrument in the first envelope.

The second and third envelopes included a set of manipulation check questions and post-experimental questions, respectively. Participants were required to complete all the questions in the second envelope. There are two sets of questions: manipulation checks and debriefing questions. The manipulation checks are made to ensure success in our manipulation, and debriefing questions are made to assess participants' consideration when making a correction decision. Then, they had to complete the last envelope which included demographic questions as well as a set of questionnaires for knowledge testing. After answering all the questions, participants returned all materials to researchers and received a Starbucks card valued 200 Baht (1 USD = THB 34.50) for their participation. Overall, it took 30–40 minutes for the required task.

4. Results

4.1 Manipulation Check

To assess the perspective taking manipulation, we asked a question to verify whether the participants cognitively engaged with the management's perspective. We asked the participants to what extent they try to put themselves in the shoes of the management who is preparing the MD&A while assessing the case materials, using an 11-point Likert scale ranging from 0 (not at all) to 10 (very much). The mean difference between prompted and unprompted perspective taking is 6.62 and 5.56. The results showed that mean difference between the two groups is statistically significant at conventional level ($F_{1,68} = 5.81$: $p = 0.0187$). These results reveal that the manipulation was successful between the two groups.

4.2 Test of Hypotheses

This paper conducted an analysis of variance (ANOVA). The likelihood of the MD&A reflecting the current state of the company and the likelihood of a positive or negative tone in the MD&A are illustrated in Tables 3 and 4. Table 3 reports descriptive statistics, the one-way ANOVA results. The mean likelihood of the MD&A reflecting the current state of the company for auditors who were prompted with a management perspective is significantly higher than that for those who were not prompted with a management perspective (5.91 and 4.86, respectively, $F_{1,68}$: p = 0.0210). Moreover, table 4 shows the likelihood of a positive tone in MD&A. For auditors who were prompted with a management perspective, the mean likelihood of a positive or negative tone in MD&A is significantly lower than it is for auditors who were not prompted with a management perspective (1.24 and 2.11, $F_{1,68}$: p = 0.0389).

The results above are not consistent with H1a and H1b since I predicted that auditors with management's perspectives would be better at accessing MD&A than auditors without management perspectives. Our results contradict those of Church et al. (2015) and Hamilton (2016). They previously demonstrated the benefit of taking the management's perspective. This study provides another piece of evidence showing the negative effects of perspective taking. In other words, management's perspective does not improve auditors' ability to accurately access MD&A. The findings demonstrate that auditors who are prompted with a management perspective are more likely to indicate that MD&A reflect the current stage of the company and have a less positive tone in an assessment decision than auditors who are not prompted with a management perspective. Our findings add additional evidence that the effects of perspective-taking as management in our setting occur through auditors' pre-existing motivation to give more weight to accessing the MD&A in accordance with management's wishes, which have begun to occur since assessment decisions.

Table 3 The likelihood of the MD&A reflecting the current state of the company. (Dependent Variable = the likelihood of the MD&A reflecting the current state of the company.[a])

Panel A: Descriptive Statistics – Mean (Standard Deviation) *N* = Sample Size			
Judgement	**Perspective Taking**		
	Prompted	**Unprompted**	**Total**
The likelihood of the MD&A reflecting the current state of the company	5.91 (1.98) *N* = 34	4.86 (1.74) *N* = 36	5.37 (1.92) *N* = 70

Table 3 The likelihood of the MD&A reflecting the current state of the company. (Dependent Variable = the likelihood of the MD&A reflecting the current state of the company.[a]) (Cont.)

Panel B: One-way ANOVA					
Sources	**Sum of squares**	**Df**	**Mean Square**	***F*-statistics**	***p*-value**
Perspective Taking	19.30	1	19.30	5.58	0.0210**
Error	235.04	68	3.46		

[a] The participants were asked to specify the likelihood of the MD&A reflecting the current state of the company using an 11-point (0–10) Likert scale, where 0 and 10 respectively denote not at all and very much.

***, **, and * respectively denote the 1%, 5% and 10% significance levels.

Table 4 The likelihood of the MD&A containing a positive tone. (Dependent Variable = the likelihood of a positive or negative tone in MD&A.[a])

Panel A: Descriptive Statistics – Mean (Standard Deviation) *N* = Sample Size			
Judgement	**Perspective Taking**		
	Prompted	**Unprompted**	**Total**
The likelihood of the MD&A containing a positive tone	1.24 (1.89) *N* = 34	2.11 (1.58) *N* = 36	1.69 (1.78) *N* = 70

Panel B: One-way ANOVA					
Sources	**Sum of squares**	**Df**	**Mean Square**	***F*-statistics**	***p*-value**
Perspective Taking	13.41	1	13.41	4.43	0.0389**
Error	205.67	68	3.02		

[a] The participants were asked to specify the likelihood of a positive or negative tone in MD&A using an 11-point (–5 – +5) Likert scale, where –5 and +5 respectively denote extremely negative tone and extremely positive tone.

***, **, and * respectively denote the 1%, 5% and 10% significance levels.

H2 predicts that the auditors who are prompted by perspective taking as a management are less likely to request the management to alter the material misstatement of the MD&A than those with unprompted by perspective taking. In Table 5, The results show that the mean responses of the probability of requesting the management alter MD&A in the presence of management-prompted and unprompted conditions are significantly different. (0.55 and 0.73, respectively, p = 0.00). Hence, the results support H2.

Table 5 The probability of a request of the management's MD&A alteration. (Dependent Variable the probability of requesting the management to alter MD&A.[a])

Panel A: Descriptive Statistics – Mean (Standard Deviation) *N* = Sample Size

Judgement	Perspective Taking		
	Prompted	Unprompted	Total
The probability of a request of the management's MD&A alteration	0.55 (0.23) *N* = 34	0.73 (0.096) *N* = 36	0.65 (0.19) *N* = 70

Panel B: One-way ANOVA

Sources	Sum of squares	Df	Mean Square	*F*-statistics	*p*-value
Perspective Taking	0.61	1	0.61	20.51	0.000***
Error	2.00	68	0.03		

[a] The participants were asked to specify the the probability of requesting the management to alter MD&A using a 0%–100%, where 0% and 100% respectively denote 0% not at all and 100% requesting the management to alter MD&A.

***, **, and * respectively denote the 1%, 5% and 10% significance levels.

4.3 Additional Analysis

Even though prompting auditors to take management's perspective will improve their understanding of management's incentive, they do not request management alter the MD&A's unusually upbeat tone because management's perspective triggers auditors' pre-existing motivation to accept an abnormally positive tone MD&A. Accordingly, we predict that management's perspective makes auditors consider maintaining client relationships to support management's desires (Figure 4, Link 1).

In turn, we anticipate that auditors' consideration of maintaining client relationships will influence their decision-making in a way that supports management's desired conclusion.

Previous literature supports the idea that auditors with pre-existing motivation are more likely to support the management-preferred conclusion in various circumstances, such as when there is a good working connection between them and the client. (Koch & Salterio, 2017). In this light, I predict auditors' consideration of maintaining client relationships will increase their propensity to accept the MD&A with an abnormally positive tone (Figure 4, Link 2).

We next conducted a mediation analysis using structural equation modeling (SEM) to determine whether client relationships explain the relationship between perspective taking and the auditors' correction decision. Our study further asked the participants a question related to the concern about maintaining a positive relationship with client using an 11-point Likert scale ranging from 0 (not at all worried) to 10 (extremely worried).

Figure 4 presents results for the effect of prompted management perspective compared to unprompted management perspective. The path coefficient for the effect of perspective taking on auditors' concerns about maintaining a positive relationship is significantly positive. In addition, the path coefficient from auditors' concerns about maintaining a positive relationship to auditors' correction decision is significantly negative. Finally, with the potential mediator included in the model, the path coefficient from perspective taking to auditors' correction decision is significant and negative. These results indicate that the effect of perspective taking on auditors' correction decision is partially explained by auditors' concerns about maintaining a positive relationship.

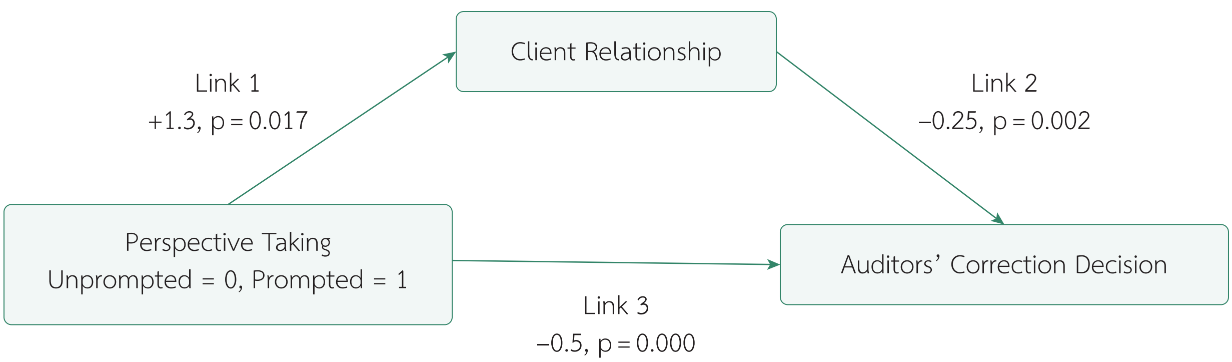

Figure 4: Mediation Analysis presents results of a structural equation analysis that tests potential mediator of the effect of perspective taking on probability of auditors' correction decision

5. Conclusion and Limitation

As management can manipulate the tone of the language used in MD&A to serve their personal interests in order to induce favorable market reactions (return on assets), influence analyst forecasts, or mask poor operating performance (Davis & Tama-Sweet, 2012; Cho et al., 2010). Prior research suggests auditors can contribute to raising the quality of the MD&A disclosure by reviewing and assessing it (Cohen et al., 2008). In accordance with ISA 720 (revised), an auditor is not required to audit the MD&A; instead, they must read it and take into account any other information that is inconsistent with the financial statements or the auditor's knowledge based on the information they gathered while conducting the audit.

The purpose of this study is to investigate whether and how perspective-taking impacts the assessment and correction decisions made by auditors when reviewing MD&A. Perspective taking is manipulated into management-prompted and unprompted conditions. The participants were audit managers from one of the Big 4 audit firms, assuming the role of audit managers. They were given the task of reviewing the MD&A. The main instrument was a set of case materials and questionnaires designed to investigate: 1) the assessment decision on the likelihood of the MD&A reflecting the current state of the company and the likelihood of the MD&A containing a positive tone 2) the correction decision on the probability of a request of the management's MD&A alteration.

The results reveal that management’s perspective affects auditors’ judgement. They are more inclined to concur with management when they are prompted by management’s perspective by indicating a high likelihood of the MD&A reflecting the current state of the company and a low likelihood of the MD&A containing a positive tone. Additionally, the auditors are less likely to request that the management alter the MD&A when they are prompted by the management perspective. As contributed and supported by Bhaskar et al. (2019), they provide evidence that auditors’ pre-existing motivation to reach management’s preferred conclusion still holds true. Perspective-taking aids auditors in comprehending management demands. Requiring management to alter MD&A, resulting in less favorable MD&A, will threaten management’s preference. Thus, our findings provide evidence that prompting auditors to take management’s perspective triggers auditors’ pre-existing motivation, which will make auditors intensify their propensity to rationalize management-preferred conclusions in both assessment and correction decisions. Bias in auditors’ decisions is divided into ex-ante and ex-post. Auditors’ assessment decision shows ex-ante bias from the auditors’ judgment and auditors’ correction decision shows ex-post bias when auditors make their decisions relating to audit tasks. Our findings have important implications for practitioners. Church et al. (2015) and Hamilton (2016) encourage audit firms to facilitate the benefit of management’s perspective to boost audit quality.

Contrary to their findings, our findings offer more support for the idea that audit firms should be cautious when attempting to apply management's perspective to reality. Moreover, our findings add to prior accounting research by providing another piece of evidence that prompting management's perspective can backfire, decreasing their ability to make accurate judgments.

This study also extends prior work on motivated reasoning in the audit context to investigate auditors' judgment processes by examining whether management's perspective stimulates auditors' pre-existing motivation to consider the circumstances that make them adopt the client's preferred conclusion. According to previous auditing research, auditors are more likely to support client-preferred aggressive accounting treatment when their relationships with their clients are close and highly amicable (Koch & Salterio, 2017). The results provide evidence that management's perspective makes auditors consider maintaining a positive relationship with their client, which enables auditors to engage in unethical actions by readily accepting MD&A that contains an abnormally positive tone. In sum, the auditors' consideration of maintaining a positive relationship with their client partially mediates the effect of management's perspective on the auditors' correction decision.

Finally, these findings of this study also contribute to the regulators and standard setters by providing bias in auditors' reviews of MD&A. As the Public Company Accounting Oversight Board (PCAOB) and Securities and Exchange Commission (SEC) debate whether the MD&A should be examined for a mandatory audit examination (PCAOB 2013a, SEC, 2002). The findings should be interesting to and helpful for regulators and standard setters that have emphasized the importance of information disclosed to the public to take stock of this study and call for other to provide for evidence informed policymaking and standard setting bodies.

Some limitations of this study could be addressed in future research. First, the results of this study are limited to the timing at which auditors obtain the MD&A since this study focuses on the impact of management's perspective on making an assessment and correction decision when they obtain the MD&A after the date of the auditor's report. Additionally, this study shows that when management's perspective is prompted, auditors yield to pre-existing motivation and come to the management-preferred conclusion. Our findings recommend further study to find factors that can lessen the negative effects of management's perspective on auditors. Despite these limitations, we believe that our analyses will contribute particularly to future research on how management's perspective affects the auditor's judgment.

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