An Examination of Audit Managers' Preference for the Underreporting of Time by Their Audit Staff

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ABSTRACT: The Public Oversight Board (2000) has raised concerns over the underreporting of time on audit engagements, noting that the practice can negatively affect audit quality and lead to other unethical behaviors which lead to increased audit risk. While the practice is prohibited by audit firm policies, if underreporting by engagement staff is tacitly rewarded by the audit managers evaluating staff work, an environment is created in which underreporting time may be necessary for staff to succeed and advance within the firm. Our study considers the role of audit managers in perpetuating the practice of underreporting by examining the extent to which, and under what conditions, managers accept (i.e., implicitly reward) such behavior in their audit staff. Utilizing an experiment in which engagement staff appear to have worked more hours than were budgeted, we manipulate staff reporting accuracy (underreporting hours worked in order to meet budget versus accurately reporting exceeding the budget) and managers' personal preference for the client (high versus low). We find that staff reporting accuracy and managers' personal preferences for the client interact disordinally to affect managers' performance evaluations of staff, with the highest evaluations going to staff who underreport when the manager's preference for the client is high, and the lowest going to staff who accurately report that they have exceeded budget when the manager's preference for the client is high. Further, we find that managers are more likely to request an underreporter on a different engagement, regardless of their preference for the current client. These results are consistent with agency theory and suggest that managers' own incentive structures influence how they evaluate their audit staff, contributing to an environment that implicitly rewards underreporting of time even though firm policy explicitly prohibits the behavior.

I. Introduction

Public accounting watchdog groups have expressed concern that the practice of underreporting can have serious hazardous effects on audit quality and can be the first stage in a slippery slope to other unethical behavior (e.g., POB 2000), all of which will have an impact on a firm's audit risk. Underreporting, or "eating time", occurs when an auditor does not charge all hours worked on a particular engagement to the client (McNair 1991). The unrealistic time budgets that result from past underreporting can cause auditors to fail to gather sufficient evidence, fail to report significant findings, and document procedures they have not performed (Otley and Pierce 1996; Donnelly et al. 2003, Coram and Woodliff 2004). However, the rewards structure in public accounting is such that audit managers (and, in turn, their staff) are rewarded for meeting staffing budgets and often punished for exceeding budgets. This results in an incentive to underreport when actual hours worked exceeds what has been budgeted for the engagement. Our study considers the role of the audit manager in perpetuating the practice of underreporting by examining the extent to which, and under what conditions, managers accept (i.e., implicitly reward) such behavior in their audit staff.

Given firm policies prohibiting underreporting (e.g., Buchheit et al. 2003; Sweeney and Pierce 2006), as well as the potential negative consequences of underreporting, partners should prefer that their engagement teams report their time accurately. However, when viewed through the lens of an agency problem, audit managers (i.e., agents) have an informational advantage over their audit partners (i.e., principals) with regard to the time reporting behavior of staff. That is, relative to partners, managers spend more time with staff at the worksite, resulting in more accurate information regarding staff hours (Otley and Pierce 1996). Thus, managers have the opportunity to overlook (or tacitly approve of) underreporting, typically without the partner's

knowledge. While there may be times when managers are more willing to accept their staff exceeding the budget (e.g., an error was found, leading to necessary additional work), there may be certain contextual or situational factors which reduce managers' acceptance of budget overruns, in turn increasing their acceptance of underreporting. One such factor that may affect how a manager views/reacts to underreporting relates to the manager's personal preference for the client. If a manager has a personal preference for a particular client (e.g., the client is close to home or in an industry of particular interest to the manager, the manager gets along well with client management, the engagement partner is influential at the firm, the timing of the engagement is convenient for the manager relative to other periods during the year), he or she may have a stronger desire for a subordinate to underreport in order to maintain audit fees near their current levels to help with client retention.

To date, there is little evidence regarding whether managers will put their own interests ahead of their firm's when it comes to underreporting. While earlier evidence from audit staff suggests that managers have implicitly encouraged them to underreport time (Lightner et al. 1983; McNair 1991), recent interviews with audit managers and partners suggest that pressures to underreport have since been reduced in public accounting firms (Buchheit et al. 2003). Thus, it is unclear if/when managers will contribute to an environment that rewards underreporting. In our study, we conduct an experiment to investigate whether, how, and under what conditions managers will prefer underreporting staff to those who exceed their budgets. We present audit managers with a scenario in which staff appear to have worked more hours than were budgeted. We manipulate reporting accuracy; that is, whether staff underreport (i.e., report meeting the budget) or reported all the hours worked (i.e., report exceeding the budget). We also manipulate

manager participants' personal preference for the client as high or low. We then have them evaluate staff performance and indicate their preference for this staff on future engagements.

Our results indicate that staff reporting accuracy and managers' personal preferences for the client interact disordinally to affect managers' performance evaluations of staff, with the highest evaluations going to staff who underreport when the manager's preference for the client is high, and the lowest going to staff who accurately report that they have exceeded budget when the manager's preference for the client is high. Interestingly, when managers (i.e., agents) are replaced by partners (i.e., principals/owners of the firm), this effect dissipates. Further, we find that managers are more likely to request an underreporter on a different engagement, regardless of their preference for the current client.

Our study contributes to the literature in a number of important ways. For example, we provide experimental evidence regarding an antecedent to audit manager acceptance of underreporting: managers' personal preferences regarding their clients. Also, despite explicit firm policies to the contrary, we demonstrate situations under which audit managers will implicitly reward underreporting, creating/perpetuating the incentives for their engagement staff that lead to the practice of underreporting. Specifically, we find that managers are more likely to select an underreporter as part of a team for a future engagement, decreasing the likelihood that an accurate reporter is assigned to desirable engagements which, in turn, can influence raises, promotions, and continued employment. Thus, our results suggest that a clear incentive structure exists for engagement staff who have exceeded their budgets and are contemplating how to record their time. Given the firm policies prohibiting underreporting that are currently in place, it may be that other actions on the part of firms and partners are necessary to further curtail such behavior.

The remainder of the paper is organized as follows. Section II discusses previous literature and develops our hypotheses. Section III details the method and Section IV outlines our results. Section V offers conclusions, limitations, and suggestions for future research.

II. Background and Hypothesis Development

Underreporting the amount of time spent on an audit engagement is formally prohibited by firm policies, as it is thought to impair audit judgments regarding engagement planning, client billing and retention, and staff evaluation (Lightner et al. 1983; McNair 1991; Buchheit et al. 2003; Shapeero et al. 2003; Sweeney and Pierce 2006). However, early survey studies of staff and seniors reveal their belief that managers often implicitly encourage the practice (Lightner et al. 1982; 1983; McNair 1991; Otley and Pierce 1996). Implicit encouragement of underreporting would likely occur in two important ways. First, managers might differentially evaluate staff performance based on perceived underreporting (Otley and Pierce 1996; Sweeney and Pierce 2006). For example, when coming in on budget is crucial to the manager, he or she may punish staff for reporting hours beyond what has been budgeted, or not punish staff when it appears they have underreported to meet budget. Second, managers may be more or less likely to choose staff for future engagements based on their willingness to underreport (Otley and Pierce 1996; Sweeney and Pierce 2006). That is, if managers have similar budgetary concerns about subsequent engagements, they may prefer to utilize audit staff who appear willing to help them meet future budgets as well. It is important to note that these two decisions can significantly influence the ultimate viability of audit staff. While some recent survey/interview studies suggest that tacit manager approval of underreporting may no longer be a problem (Buchheit et al. 2003;

Sweeny and Pierce 2006), agency-related incentives for managers still exist and there is some anecdotal evidence that managers may still be implicitly encouraging underreporting.[1]

Underreporting and the Agency Problem

An agency problem exists in all organizations and cooperative efforts in which a principal (e.g., an owner or partner) utilizes an agent (e.g., a manager) for the purpose of delegating responsibility to him or her (Jensen and Meckling 1976). Agency theory suggests that, as long as the goals of the principal and agent are aligned, the agent will make decisions that maximize the goals of the principal. However, when the goals of the principal and agent diverge and the agent has the opportunity to act in his/her self-interest (i.e., has relevant information that the principal lacks, referred to as "information asymmetry"), agency theory predicts that the agent will make decisions that maximize his/her self-interest over the principal's interests (Jensen and Meckling 1976; Booth and Schulz 2004). Prior research supports the notion that agents tend to act in their own interest when they have both the incentive and opportunity to do so. For example, agents have been shown to continue failing projects in order to avoid negative reputational effects and to manage earnings to achieve higher bonuses (e.g., Jensen and Meckling 1976; Booth and Schulz 2004; Beaudoin et al. 2009).

On an audit engagement, an audit manager acts as an agent of the audit firm which is controlled, or "owned", by the audit partners. The manager generally has a more "hands on" role in the day to day activities of the engagement than the partner (Wolf 1981). Because of this, there is likely to be information asymmetry between the partner and the manager regarding certain aspects of the audit. For example, managers likely have a better idea of how many hours their staff actually work, given that they typically spend more time on-site and interact more

[1] Anecdotal examples can be found on the auditor blog site http://goingconcern.com/2009/08/eating-hours-are-you-in-denial.php.

regularly with the engagement team than partners (Gibbins and Trotman 2002). Thus, the manager is often faced with a choice similar to what has been described as an information dilemma.[2] In such cases, the manager can encourage the provision of accurate information to achieve a positive collective outcome for the firm or encourage strategic misrepresentation of the hours worked by the engagement team in order to secure a positive outcome for him/herself.

Manager Incentives: Realization Rates and Client Retention

Since managers' performance evaluations and promotion potential are influenced, in part, by whether or not the engagement is completed within the budgeted time, managers who underreport in budget overrun situations generally obtain better personal outcomes than those who accurately report the overrun (McNair 1991; Akers and Eaton 2003; Shapeero 2003). This assumes that partners' evaluations of managers do not take into account the underreporting (i.e., there is information asymmetry). Additionally, managers are likely to prefer some clients over others, causing them to be particularly motivated to ensure that the relationship with these preferred clients continues. The likelihood of retaining a client improves as audits are completed closer to budgeted hours (Hackenbrack and Hogan 2005). As resource constraints have intensified under the Sarbanes-Oxley Act (SOX) of 2002, retention of marginally profitable clients is even more tenuous (Rama and Read 2006). Thus, managers have additional incentives to underreport hours for clients that they highly prefer for personal/career-related reasons.

Given that low realization rates lead to an increased chance of severing the relationship with a client (either due to the firm severing the relationship for profitability reasons or the client severing the relationship as a result of the firm raising fees), managers may tacitly approve of

[2] An information dilemma refers to the decision of whether to provide accurate information to achieve a collective favorable outcome or to strategically misrepresent information in order to secure a stronger personal outcome (Steinel and De Dreu 2004).

underreporting in order to avoid losing a client for which they have a personal preference. Such a preference for a client may result from various situational and contextual characteristics relating to personal and/or career benefits that are inherent in the client. For example, a manager may have a personal preference for: a client that is within the manager's industry of interest, an engagement that involves an influential partner at the manager's office, a client that is convenient for the manager's work schedule, or client management that the manager gets along particularly well with personally.

Since a manager who has a strong personal preference for a client will be more concerned about losing that client, the information dilemma faced by the manager will be more pronounced. That is, the manager may have a heightened sensitivity to budget overruns that would reflect poorly on his or her management of the engagement or that could eventually lead to a severing of the relationship with that client. In these circumstances, the manager has greater incentive to tacitly approve of strategic misrepresentation of the hours worked on the engagement by evaluating underreporters higher than honest reporters. On the other hand, when a manager does not have a strong preference for the client, he or she will likely be less concerned with losing the client, reducing any information dilemma. That is, agency theory implies a "consequence based" approach to the decision making process (Shapeero et al., 2003), suggesting that managers will approve of underreporting when it benefits them and will be less likely to accept underreporting when the benefits are less clear. Thus, we arrive at the following interaction hypothesis:

H1: Staff reporting accuracy and preference for the client will interact to affect managers' evaluations of staff, such that nonaccurate reporting/high client preference will result in the highest evaluation while accurate reporting/high client preference will result in the lowest evaluation.

Reputation Effects

The choice of particular team members for an engagement has implications for the audit manager. The manager has a personal stake in the performance of the team (Kaplan and Reckers 1985), and working with a subordinate who has a reputation for being inefficient could result in budget overruns. Concerns regarding reputation effects are particularly heightened in the audit profession, which has long been described as having an "up or out" mentality (Dalton et al. 1994), and prior research in performance evaluation settings suggests a connection between budgetary overruns and reputation (Kaplan and Reckers 1985; Jones and Chen 2005).

Suppose, for example, that a manager has worked with two audit seniors on past engagements. Assume one of the seniors has, on occasion, missed budgets significantly and the other has almost always met his/her budgets (although the manager suspects he/she is underreporting their time). If, in an effort to protect the budgets of future engagements, the manager is more likely to select the underreporter than the accurate reporter, there are potentially serious negative implications for the accurate reporter (e.g., the accurate reporter is less likely to be assigned to desirable engagements in the future which, in turn, can influence raises, promotions, and continued employment) (Doby and Caplan 1995). While favoring underreporters when selecting engagement teams can be beneficial to a manager's future realization rates, it can have negative implications for the firm (and, by extension, its "owners") if honest, competent employees are underutilized and eventually counseled out.

The choice of working with particular seniors or staff on future engagements presents a different set of dilemmas to managers than evaluating their performance on a completed engagement. That is, *past* performance evaluations may not relate directly to a manager's desire to select that individual for other *future* engagements (Kaplan and Reckers 1985). For instance, a

manager may be willing to more favorably evaluate an accurate reporter who exceeds budget (particularly with a non-preferred client), but in general still may be disinclined to select someone for future engagements who has demonstrated a reluctance to underreport, as such a reluctance would hurt the manager's chances of meeting future budgets (i.e., a personal incentive). Thus, on average, we expect managers to prefer underreporters (relative to more accurate reporters who have gone over budget) on future engagements given their concern for and attention to realization rates. We, therefore, propose the following main effect hypothesis:

H2: Audit managers will be more likely to request a senior for a different engagement when the senior underreports on the current engagement than when the senior accurately reports exceeding the budget.

III. Method

Participants

Participants were 100 practicing auditors with an average of 9.7 years of audit experience.[3] Given the performance evaluation task, participants should have experience evaluating the performance of subordinates. However, they should be below the rank of partner, as that shifts their role in the firm from one of agent (manager) to principal. Thus, all participants had experience evaluating subordinates (6.8 years, on average) and were primarily managers and senior managers in their firms. Participants were from international (26%), national (20%), large regional firms (42%), and smaller firms (12%).[4] There are no significant differences (p's > .20)

[3] We mailed instruments to 900 managers from a list of accountants who are members of the American Institute of Certified Public Accountants. We received replies from 109 individuals and 45 were returned as undeliverable. The resulting response rate is 12.75% (109 responses divided by 855 delivered). There were no differences between early and late respondents. There were 9 unusable responses resulting from completion by inappropriately classified individuals such as staff accountants, payroll clerks, and tax accountants (our conclusions remain the same with or without these individuals). The sample size drops slightly below 100 for some dependent variables because a few participants did not record responses for those measures.

[4] One participant was a "heavy" senior with significant evaluation responsibilities. Results are unaffected by the removal of this less experienced participant or by the removal of participants from smaller regional firms.

for participants across experimental conditions for any of the demographic measures (e.g., overall audit experience, position, experience evaluating subordinates, or firm type).

Experimental Task and Procedure

Participants were asked to assume the role of manager on a hypothetical audit engagement and were given background information on the client and the engagement. In addition they were given information on the current year audit and the engagement team. They were told that a clean opinion was rendered on the client after some adjustments to the financial statements were made. Information provided to participants relating to the senior on the engagement included generally positive information. However, a mildly negative piece of information was provided in order to generate variability in participants' responses and to reduce the likelihood of a ceiling effect. Specifically, each participant was told the following: the senior, Lisa Martin, was a new member of the engagement team this year; this was your first time working with her; she seemed to have a good rapport with the client and her staff; she kept you informed of unusual items; she made few documentation errors; and she occasionally contacted you with questions regarding proper firm procedure which you hope on future engagements she will be more prepared to apply on her own. Participants were then given more detailed information about the engagement and responded to questions about their perceptions of the senior's performance. Finally, participants answered a series of case-related and demographic questions, including manipulation checks.

Independent Variables

We utilized a 2 x 2 (reporting accuracy by preference for client) between-participants design. We manipulate reporting accuracy as either underreporting or accurate reporting of hours

worked by the engagement team. In both cases, there are indications that the engagement team worked more hours than budgeted. In order to establish this, participants were told that they felt confident the team worked beyond the budgeted hours throughout the engagement and that engagement team members often left voicemails and sent electronic workpapers for review before 8 a.m. and after 7 p.m. In the "underreport" condition, participants were told, "Although Lisa and the rest of the engagement staff appeared to work long hours, *their reported hours did not exceed their time budget*." Because it had been previously established in both conditions that the engagement team worked more hours than budgeted, the participants were led to infer that Lisa and the engagement team underreported their hours in the "underreport" condition. In the "accurate reporting" condition, participants were told that, "Lisa and the rest of the engagement staff appeared to work long hours *and their reported hours significantly exceeded their time budget (i.e., it appears that all excess hours worked were reported)*."

The second independent variable, personal preference for the client, is manipulated as either high or low. We manipulate several aspects of the engagement since a particular manager may value (on a personal level) certain dimensions more than others, depending on their lifestyles and priorities. For example, participants in the *high* (low) client preference condition were informed: they "have *always* (never) gotten along particularly well with client management on a personal level" and that "the recent audit was no exception"; this client is their *only client* (one of 6 clients) with this fiscal year end (i.e., it either is, or is not, a hectic time for them); the client is located *near* (far) from their home with *little* (heavy) traffic on the commute; the partner on the engagement "is a *very experienced* (new junior) partner in your office" who has some "*high* (low) profile engagements that you *would be interested* (have little interest) in working on in the future."

Dependent Variables

To test H1, we examine participants' evaluations of the audit senior's performance. Participants were asked to rate the senior's *overall performance* with respect to this engagement. As a secondary measure that relates more specifically to the issue of reported hours, we also asked participants to rate the senior's *time management skills*. Participants recorded their responses for these measures on eleven-point scales, where 1 = "poor" and 11 = "outstanding". Both measures were based on actual evaluation forms used in public accounting. For H2, we asked how likely they were to request the senior on a different engagement in the future. Responses were again recorded on an eleven-point scale, where 1 = "very unlikely" and 11 = very likely".

IV. Results

Manipulation Checks

Manipulation checks for both independent variables indicate that participants understood the manipulations. Participants were asked how likely they feel it is that all of the hours worked on the engagement were recorded. They indicated their responses on an 11-point scale where 1 = "Very Unlikely" and 11 = "Very Likely". Participants in the underreporting condition reported an average response of 3.94 compared to an average response of 8.67 in the accurate reporting condition ($p < 0.001$). Participants were also asked about the strength of their personal preference to retain the client on an 11-point scale in which 1 = "Very Weak" and 11 = "Very Strong". Participants in the high client preference condition reported an average response of 9.38 compared to 5.73 for participants in the low preference condition ($p < 0.001$).

Hypothesis Testing

Results relating to our hypotheses are analyzed within a 2×2 ANOVA framework (reporting accuracy by preference for client), with managers' evaluations of seniors and their likelihood of requesting the senior on a future engagement serving as the dependent variable. Due to the directional nature of expectations, all tests of hypotheses are one-tailed.

Hypothesis 1 predicts a disordinal interaction for the effect of our two independent variables (reporting accuracy and client preference). Table 1 reports ANOVA results using participants responses to the "overall performance" question described above as the dependent variable. The cell means presented demonstrate the nature of this statistically significant disordinal interaction ($p < 0.002$), which provides support for H1. On an eleven-point scale, participants rate the senior's performance highest when their personal preference for the client is high and the senior underreports (mean = 8.00). The senior who exceeds the budget (i.e., reports accurately) when participants' preference for the client is high receives the lowest evaluations (mean = 6.77). Consistent with the prediction of a disordinal interaction, participants' mean evaluations are 7.70 for the accurate reporter and 7.50 for the underreporter when preference for the client is low. Results using our secondary performance evaluation measure, reported in Table 2, are consistent with the findings of the general evaluation measure. That is, the interaction of client preference and reported hours is significant ($p = 0.047$) such that the senior was evaluated most highly for her time management skills when she underreported for the high preference client (mean = 6.72) and was evaluated the lowest when reporting accurately for the high preference client (mean = 5.14).

[Insert Tables 1 & 2]

Hypothesis 2 predicts that audit managers will be more likely to request, for a different engagement, a senior who underreports than a senior who accurately reports exceeding the budget. Table 3 presents ANOVA results using participants' responses to their likelihood of requesting the senior on a different engagement as the dependent variable. There is a highly significant main effect of hours reported on this likelihood ($p < 0.002$). The mean responses for the underreporting and accurate reporting conditions are 7.92 and 6.82, respectively. These results support H2.

[Insert Table 3]

Additional Analyses: Partner Data

The results presented above using managers as participants demonstrate that, to some extent, managers tacitly approve of underreporting by their audit team. Our discussion of agency theory suggests that managers are acting in a utility maximizing manner, potentially to the detriment of the firm (and its owners, i.e., partners). We expect that partners would react differently than managers in this setting. That is, as owners of the firm, their personal interests are more aligned with the firm's interests and, thus, partners will not face the same information dilemma as managers. With regard to the performance evaluations of subordinates (H1), we would not expect partners to display the same pattern of results predicted for managers (i.e., disordinal interaction). Specifically, we expect partners will not reward staff who underreport when they have exceeded budget more than staff who exceed budget but report accurately.

To test this supposition, we had 119 audit partners consider the same case that we presented to managers.[5] We then asked them to provide an overall performance evaluation for

[5] We mailed instruments to 850 partners from a list of accountants who are members of the American Institute of Certified Public Accountants. We received replies from 125 individuals and 63 were returned as undeliverable. The resulting response rate is 15.96% (125 responses divided by783 delivered). There are no significant differences

the subordinate. We combine the partner data with the manager data used in our primary analyses and reanalyze the pooled data including a new independent variable, auditor rank. Consistent with agency theory, we predict a three-way interaction in which the disordinal relationship found with manager participants will not hold for partner participants.

Results of analyses for the overall performance evaluation variable (the primary H1 dependent measure) using the combined data sets (managers and partners), are reported in Panel A of Table 4. Note that the significance level of the two-way interaction of reporting accuracy and client preference drops from $p < 0.002$ (Panel A, Table 1) to $p = 0.015$ (Panel A, Table A) upon inclusion of the partner data. This is due to the significant three-way interaction of reporting accuracy, client preference, and participant rank ($p = 0.024$). The form of this three-way interaction is indicated by comparing the pattern of means demonstrated for managers (Panel B, Table 1) to the pattern of means for partners (Panel B, Table 4). Note that the disordinal interaction predicted and found using managers as participants (H1) does not exist when partners evaluate the subordinate. That is, nontabulated results show that the interaction of reporting accuracy and client preference is not significant when partner responses are analyzed separately ($p = 0.889$). In addition, the partner data shows no main effect for reporting accuracy ($p = 0.790$), suggesting that partners do not reward subordinates for underreporting time.

[Insert Table 4]

V. Conclusions

The Public Oversight Board (2000) has raised concerns over the underreporting of time on audit engagements, noting that the practice can negatively affect audit quality and lead to other unethical behaviors. While the practice is prohibited by audit firm policies, if

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between early and late respondents. There were 6 unusable responses due to a failure to complete key dependent variables, resulting in 119 usable responses.

underreporting by engagement staff is tacitly rewarded by the audit managers evaluating staff work, an environment is created by which underreporting time may be necessary for staff to succeed and advance within the firm. We consider audit managers' evaluations of staff performance within the context of an agency problem, where audit managers have an informational advantage over their audit partners with regard to the time reporting behavior of staff. This advantage allows managers to implicitly reward underreporting (without partner knowledge) if it benefits them, even though underreporting may have negative consequences to the firm. The manager can use this advantage, particularly for preferred clients, to help achieve the budget, thus maintaining audit fees near their current levels and improving the likelihood of retaining the client.

To consider if and when managers may contribute to a culture of underreporting, we conduct an experiment in which engagement staff appear to have worked more hours than were budgeted. We manipulate staff reporting accuracy (underreporting hours worked in order to meet budget versus accurately reporting exceeding the budget) and managers' personal preference for the client (high versus low). Results indicate that staff reporting accuracy and managers' personal preferences for the client interact disordinally to affect managers' performance evaluations of staff, with the highest evaluations going to staff who underreport when the manager's preference for the client is high, and the lowest going to staff who accurately report that they have exceeded budget when the manager's preference for the client is high. Interestingly, when managers (i.e., agents) are replaced by partners (i.e., principals/owners of the firm), this effect dissipates. Further, managers' tacit approval of underreporting time has a broader effect on the staffing of future engagements as managers prefer underreporters on a future engagement, regardless of their preference for the current client.

Our study contributes to the literature in several ways. First, despite explicit firm policies to the contrary, we demonstrate situations under which audit managers will implicitly reward underreporting, creating/perpetuating the incentives for their engagement staff that lead to the practice of underreporting. Specifically, we find that managers are more likely to select an underreporter as part of a team for a future engagement, decreasing the likelihood that an accurate reporter is assigned to desirable engagements which, in turn, can influence raises, promotions, and continued employment. Thus, our results suggest that a clear incentive structure exists for engagement staff who have exceeded their budgets and are contemplating how to record their time. We also provide experimental evidence regarding a potential antecedent to audit manager acceptance of underreporting. We find that managers' own personal considerations regarding their clients can lead to the implicit rewarding of subordinates who underreport.

In a broader sense, our findings suggest a subculture in public accounting that works counter to the interests of the firm. Such a subculture has the potential to leave engagement staff conflicted about appropriate conduct/behavior and to push those who are unwilling to underreport out of the profession (either of their own accord or due to negative reputation effects). This would have some potentially troubling implications for the occurrence, acceptance, and escalation of additional unethical behaviors. Partners should consider that they may not be able to address these issues solely by setting firm policies to prohibit such behavior, and that other action on their part may be necessary to curtail it. Future research, as well as professional training, may want to explore, for example, how incentive structures for managers can be developed to avoid the implicit environment which contributes to the practice of underreporting.

Such research will further our understanding of the factors that affect the dysfunctional practice of underreporting.

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TABLE 1

Performance Evaluation

Panel A: ANOVA Results

Independent Variable	df	F-Statistic	p-value
Hours Reported	1	4.664	0.033
Client Preference	1	0.827	0.365
Interaction	1	9.115	0.002

Panel B: Mean (Standard Deviation)

	Low Client Preference	High Client Preference	Row Means
Budgeted Hours Reported (Underreport)	7.50 (1.30) [*n*=26]	8.00 (1.23) [*n*=25]	7.75
Actual Hours Reported (Exceed Budget)	7.70 (1.03) [*n*=27]	6.77 (1.15) [*n*=22]	7.29
Column Means	7.60	7.43	

[a] Where expectations are directional, p-values are based on one-tailed tests.

TABLE 2

Evaluation of Senior's Time Management Skills

Panel A: ANOVA Results

Independent Variable	df	F-Statistic	p-value
Hours Reported	1	10.28	0.002
Client Preference	1	0.027	0.869
Interaction	1	2.86	0.047

Panel B: Mean (Standard Deviation)

	Low Client Preference	High Client Preference	Row Means
Budgeted Hours Reported (Underreport)	6.12 [*n*=25]	6.72 [*n*=25]	6.42
Actual Hours Reported (Exceed Budget)	5.63 [*n*=27]	5.14 [*n*=22]	5.41
Column Means	5.87	5.98	

[a] Where expectations are directional, p-values are based on one-tailed tests.

TABLE 3

Likelihood to Request Senior on Future Engagement

Panel A: ANOVA Results

Independent Variable	df	F-Statistic	p-value
Hours Reported	1	9.179	0.002
Client Preference	1	0.113	0.738
Interaction	1	0.107	0.744

Panel B: Mean (Standard Deviation)

	Low Client Preference	High Client Preference	Row Means
Budgeted Hours Reported (Underreport)	7.80 (1.73) [*n*=25]	8.04 (1.55) [*n*=23]	7.92
Actual Hours Reported (Exceed Budget)	6.81 (2.22) [*n*=27]	6.82 (1.53) [*n*=22]	6.82
Column Means	7.29	7.46	

[a] Where expectations are directional, p-values are based on one-tailed tests.

TABLE 4
Performance Evaluation
Partner Respondents Included in Sample

Panel A: ANOVA Results

Independent Variable	df	F-Statistic	p-value
Hours Reported	1	1.698	0.194
Client Preference	1	0.752	0.387
Rank	1	0.110	0.741
Hours Reported x Client Preference	1	4.782	0.015
Hours Reported x Rank	1	2.831	0.094
Client Preference x Rank	1	0.152	0.697
3-Way Interaction	1	3.950	0.024

Panel B: Mean (Standard Deviation)
Partner Respondents Only

	Low Client Preference	High Client Preference	Row Means
Budgeted Hours Reported (Underreport)	7.43(1.55) [*n*=28]	7.38 (1.40) [*n*=21]	7.41
Actual Hours Reported (Exceed Budget)	7.53 (1.21) [*n*=36]	7.41 (1.10) [*n*=34]	6.47
Column Means	7.48	7.40	

[a] Where expectations are directional, p-values are based on one-tailed tests.