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0521418445 - Judgment and Decision-Making Research in Accounting and Auditing

Edited by Robert H. Ashton and Alison Hubbard Ashton

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The study of behavioral decision making has recently expanded into the area of accounting and auditing. This branch of research seeks to understand the cognitive processes that govern such necessary functions as the pricing of products and services, evaluating corporate performance, granting credit to prospective borrowers, and investing in financial securities.

In *Judgment and Decision-Making Research in Accounting and Auditing*, editors Robert and Alison Ashton present and review more than 20 years of research in decision-making science. The book analyzes the judgments that business managers, investors, auditors, and creditors make daily. It considers the assets and liabilities of applied decision making and makes suggestions for future research.

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Cambridge Series on Judgment and Decision Making

Judgment and decision-making
research in accounting and auditing

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The purpose of the series is to convey the general principles of and findings about judgment and decision making to the many academic and professional fields to which these apply. The contributions are written by authorities in the field and supervised by highly qualified editors and the Publications Board. The series will attract readers from many different disciplines, largely among academics, advanced undergraduates, graduate students, and practicing professionals.

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Judgment and decision-making research in accounting and auditing

Edited by

Robert H. Ashton and Alison Hubbard Ashton

Duke University



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Series preface

The Society for Judgment and Decision Making first collaborated with Cambridge University Press in 1986, with the publication of *Judgment and Decision Making: An Interdisciplinary Reader*, edited by Hal R. Arkes and Kenneth R. Hammond. As the editors stated in their introduction, “judgment and decision making are of critical importance, and the fact that it is possible to study them in a scientific, empirical manner is a new and exciting event in the recent history of science” (p. 1). The decade of the 1980s witnessed the flowering of the area of human judgment and decision making. The founding and expansion of the Society was one feature of this growth. At the same time, there has been an explosion of research and teaching in departments of psychology, economics, and schools of business, engineering, public policy, and medicine, with significant practical contributions through applied research and consulting in public and private institutions.

The Arkes and Hammond *Reader* was successful as an outline of the core ideas and approaches of the field and an illustration of the impressive range of useful applications. The Society, with Ken Hammond’s encouragement, recognized the potential for a series of books to provide an educational and intellectual focus for the continued growth and dissemination of judgment and decision-making research. Each book in the series will be devoted to domains of practical or theoretical interest, offering an accessible presentation of the best new ideas and empirical approaches from the field of judgment and decision making.

The Publications Committee is pleased to proffer this volume. Accountants have long recognized that they are in the business of providing information to decision makers. As early as 1966, a committee of the American Accounting Association defined accounting as “the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions” (*A Statement of Basic Accounting Theory*, p. 1). Accountants supply information to investors, creditors, and government regulators, as well as

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managers inside the firm, who rely upon this information for critical operating and strategic decisions. Accountants also perform audits, assuring decision makers that information is as accurate, timely, and useful as possible. Increasingly, accountants operate in a complex global business environment, with rapidly evolving information technology and increasing scrutiny of accounting regulation. Accountants must comprehend and manage the uncertainty and risk inherent in their professional activities while maintaining their role as facilitators of economic decision making. Thus, accounting is an ideal proving ground for the theories and insights of judgment and decision making. We expect this volume will entice researchers from the two fields into a productive dialogue.

Don K. Kleinmuntz, Chairman
for the Publications Committee

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Preface

This book describes the current state of judgment and decision-making research in the field of accounting and auditing and suggests possible directions for such research in the future. It is part of the “shelf-of-books” series of the Society for Judgment and Decision Making. The purpose of the series is to consolidate much of what is known in the field of judgment and decision making, and to make this knowledge accessible to a wide range of readers. Consistent with this broad goal, this particular book is intended to play two different roles for two different audiences.

The first audience is accounting and auditing researchers who are active, or might wish to become active, in this research area – particularly younger members of this group, such as new faculty and doctoral students. For this audience, the book is intended to provide state-of-the-art coverage of judgment and decision-making research in accounting and auditing and to set the stage for further work over the next several years. Consequently, each chapter contains a wealth of material about what currently is known in the particular area covered in the chapter *and* the authors’ opinions about this area (what it contributes to knowledge, where research should or should not go from here, etc.). In this respect, the book seeks to document the development of the field to date, to provide some coherence to a diverse and fragmented research literature, and to influence future research directions. We hope it will be a significant positive force in shaping the production of future knowledge on judgment and decision-making issues in accounting and auditing.

The second audience for the book consists of scholars who work outside the immediate field, including judgment and decision-making researchers at both the basic and applied levels, and accounting and auditing researchers whose work derives from nonjudgmental paradigms. For this audience, the book is intended to help explain what judgment and decision-making research in accounting and auditing is all about, why judgment and decision-making topics in this field are important, and how research in accounting and audit-

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ing relates to judgment and decision-making research defined more broadly. We suspect that many researchers have more difficulty appreciating the relevance of judgment and decision-making research in accounting and auditing than in other applied areas (such as marketing or medicine). We hope this book will help inform our judgment and decision-making colleagues outside our immediate field.

To facilitate the production of a high-quality book, we held two conferences at the Fuqua School of Business at Duke University. The first was an informal “summer camp” involving only the authors of the various chapters. Rough drafts were presented to share ideas and generate new ones about the content of each chapter, to assess the current status of the various parts of the field, and to coordinate among ourselves the issue of who was to cover what in the various chapters. The second was a more formal symposium at which the completed chapters were presented. The attendees consisted mainly of judgment and decision-making researchers in accounting and auditing and in the underlying disciplines. After this event was held, the chapters were revised extensively to incorporate the many ideas generated at the symposium. The result is a set of chapters that feature an excellent blend of breadth and depth in their coverage of the principal streams of judgment research in accounting and auditing.

Robert H. Ashton
Alison Hubbard Ashton

Acknowledgments

Projects of this scope are not possible without the support and encouragement of many people. We would like to recognize our indebtedness to several individuals who, directly and indirectly, enabled this book to be written. These include the KPMG Peat Marwick Foundation and its personnel, and several scholars in both the judgment and decision-making field and in accounting and auditing. Our principal debt, however, is to the authors who contributed chapters to the book. We solicited from the authors the best, most thoughtful work they could produce. They not only answered our call, but graciously tolerated our (not-too-successful) efforts to produce the book in a timely fashion.

A generous grant from the international accounting and auditing firm of KPMG Peat Marwick, through its foundation, enabled two conferences to be held at Duke University at which all the chapters were presented and discussed. KPMG Peat Marwick's record of support for a broad range of fundamental and applied research in accounting and auditing is unsurpassed. The firm has not only supplied funding, data, and professional subjects to many researchers, but also has been open to implementing insights and results provided by research. Tim Bell, Bob Elliott, Bernie Milano, and John Willingham have played especially significant roles in providing both the overall support and the support for this particular effort, and they deserve our deepest gratitude.

We are indebted to Ken Hammond who, as president of the Society for Judgment and Decision Making, first proposed the "shelf-of-books" series and encouraged us to produce a volume for it. We also are grateful to the Society's publications committee that approved the concept for the book (John Carroll, Don Kleinmuntz, and Jim Shanteau). We are especially grateful to Don Kleinmuntz, who provided extensive comments on earlier drafts of all chapters and played a significant role in shaping the book.

Our debt extends to many judgment and decision-making researchers

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whose published work has strongly influenced the development of the allied work in accounting and auditing. At the risk of omitting some researchers whose work has been influential, we want to explicitly recognize ten scholars in the underlying discipline: Robyn Dawes, Ward Edwards, Hillel Einhorn, Baruch Fischhoff, Robin Hogarth, Daniel Kahneman, Sarah Lichtenstein, John Payne, Paul Slovic, and Amos Tversky. Many of these individuals not only have contributed by virtue of their own research, but also in more personal ways, including providing comments on working papers, speaking at accounting and auditing workshops and seminars, informal conversations at J/DM and Bayesian conferences, and general encouragement and support for judgment researchers in accounting and auditing. Above all others, these comments describe Hilly Einhorn, whose death in 1987 left a void in the judgment and decision-making community that will long be felt by both basic and applied researchers.

Established scholars in accounting and auditing have provided equally strong encouragement and support for judgment and decision-making research. Again at the risk of omitting some individuals to whom our field is indebted, we want to mention Jake Birnberg and Nick Dopuch. Both have been strongly involved in judgment and decision-making research in accounting and auditing – as researchers, editors, supporters, and critics – from the earliest days to the present. We are grateful to them.

Finally, we wish to take this opportunity to recognize John Willingham. Since completing one of the earliest “behavioral accounting” dissertations at Ohio State University in 1963, John has been both a researcher and a leader in the efforts to merge research with practical concerns. After 15 years as an academic researcher and teacher (during which he also coauthored an innovative textbook on auditing), John became a partner in Peat Marwick Mitchell & Co. (now KPMG Peat Marwick) in 1978, where until 1993 he played a critical linchpin role between the practical and academic sides of our profession. John was extremely influential in his firm’s efforts to implement the results of judgment and decision-making (and other) research, and he channeled the firm’s research support to productive uses in the academic community. At the same time, he continued to do research, with both academic and practical aims. In 1993, John returned to academe at the University of Texas at Austin. Our field has benefitted greatly from John Willingham’s many contributions, and our debt to him is significant.