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Student Perceptions of Auditor Responses to Evidence of Suspicious Activities: An Experimental Assessment

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ABSTRACT

This study assessed student perceptions of auditor responses to evidence that a client failed to respond appropriately to suspicious activities that could indicate money laundering. Subjects were presented with a series of randomized cases in which partner type (new vs. experienced), firm type (regional vs. international) and audit fee materiality (not material, material to the local office only, material to the firm) were manipulated asked to indicate their perceptions of the likelihood that an audit partner would discuss such evidence with the client, and the likelihood that the issue would be disclosed by the auditor. Both partner type and audit fee materiality was found to have significant effects on perceived likelihoods.

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1.0 INTRODUCTION

Labatron Sucharow, (2012) recently reported that 26 percent of financial service professionals in the United States and United Kingdom disclosed that they had observed or had first-hand knowledge of wrongdoing in the workplace. They also reported that almost one quarter of the 500 respondents believed that financial service professionals need to engage in unethical or illegal activities to be successful. These survey results are consistent with Reed and Yeager's (1996) observation that organizational crime may be endemic and epidemic. In such an environment auditors must respond appropriately to evidence of suspicious activity.

Money laundering is an example of one the types of illegal activity that may take place in a financial institution, and one to which auditors must appropriately respond. For example the Swiss have reported that they are investigating 53 cases of suspicious banking relations in conjunction with their investigation

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of FIFA (Knoblauch, 2015). Victor Ponta appears to be the first sitting Prime Minister in Romania's history to face a criminal trial for forgery, money laundering, and complicity in tax fraud (Bloomberg, 2015a). The U.S. Justice Department recently announced that had subpoenaed Banco Nacional de Mexico (Banamex), a wholly owned subsidiary of Citygroup, as part of their investigation of illicit cash movement (Bloomberg, 2015b).

This article uses cases to analyze auditor responses to evidence of money laundering activity while taking into account the length of the audit partner's relationship with the client, the type of audit firm (regional or international), and the materiality of the audit fee. The paper begins with a review of auditor responsibilities to detect irregularities and illegal acts. Economic theory is then used to analyze auditor payoffs and incentives. The potential effects of audit fee materiality and audit firm tenure on auditor decisions and on audit quality are discussed in the following section and then related variables are used as treatments in a series of 2x2x3 factorial-design cases.

Study participants were 203 upper-division undergraduate and graduate students from two institutions, a large public university (146 subjects) and a small, liberal-arts college (57) subjects. Data were analyzed using ANOVA models and, as shown in the results section below, both audit partner tenure and fee materiality had significant effects on projected auditor actions. Subjects indicated that the likelihood of issue discussion with the client and subsequent disclosure decrease with increased audit fee materiality. From a policy point of view it may be important to auditors to document that key audit decisions were made without taking into account the materiality of the audit fee and the potential loss of the audit client on audit firm revenue. In addition, the results demonstrate that inexperienced audit partners may be less likely to address key or sensitive issues with client management. Thus audit firms may want to mentor new auditor partners to ensure that those critical discussions do take place. The paper concludes with recommendations for both practice and future research and sets for a number of policy recommendations.

Literature Review

In this section we review professional pronouncements related to auditor responsibilities to detect and respond to illegal acts like money laundering. This section explains the need for auditors to respond to indications of money laundering and the auditor actions required by the relevant professional pronouncements. This is followed by a review of the literature related to economic assessments of auditor cost/benefit tradeoff, and audit firm tenure and audit quality. Finally the hypotheses to be tested are developed.

1.01 AUDITOR RESPONSIBILITIES

Auditors in the United States follow two different sets of auditing standards. Public Company Accounting Oversight Board (PCAOB) standards apply in the audit of publically listed companies with American Institute of Certified Public Accountants (AICPA) auditing standards apply in all other audits. PCAOB audit standard AU Section 317 defines an illegal act as "violations of laws or governmental regulations" (PCAOB, AU 317.01).

PCAOB and AICPA auditing standards recognize that laws and regulations may affect financial statements, but that the effect may vary considerably (PCAOB, AU 317-04; and AICPA, AU-C 250.02). In addition, both PCAOB and AICPA auditing standards differentiate between laws and regulations that are "generally recognized to have a direct effect on the determination of material amounts and disclosures on the financial statements" (AICPA, AU-C 250.06) and those that do not (PCAOB, AU 317.04). Thus the standard differentiates between direct- and indirect-effect laws and regulations. Auditors are required to obtain sufficient and appropriate audit evidence about material amounts and related disclosures for direct-effect laws and regulations. They are only required to perform specified audit procedures that may identify noncompliance with indirect-effect laws and regulations. The AIPCA standard specifically mentions tax and pension laws and regulations as having a direct effect on the financial statements. The PCAOB auditing standard recognizes that "an audit made in accordance with generally accepted auditing

standards provides no assurance that illegal acts will be detected or that any contingent liabilities that may result will be disclosed." (PCAOB, AU 317.07). The PCAOB standard further states that "Normally, an audit accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts." (PCABO, AU 317.08).

The AICPA auditing standard on the consideration of laws and regulations states that auditors should discuss suspected noncompliance with laws and regulations with management (AICPA, AU-C 250.18). The standard further states that if the noncompliance is, in the auditor's professional judgment intentional *and* material, then it should be communicated to those charged with governance (emphasis added). Finally, if noncompliance with laws and regulations has an undisclosed material effect on the financial statements, then the AICPA audit standard requires that the auditor express a qualified or adverse opinion on the financial statements (AICPA, AU-C 250.24). PCAOB AU 317.10 requires that auditors inquire of management at a level above those involved in the illegal act to evaluate the effect of the discovered illegal act on the financial statements. Auditors are also charged by the PCABO to consider the effect of an illegal act on the financial statements, the financial statement disclosures, and the relation of the illegal act to other areas of the audit. (PCAOB, AU 317.14-.16).

1.02 ECONOMIC INCENTIVES AND THE AUDITOR

A second issue related to auditor responsibilities is that of auditor motivation or incentive. The traditional view is that auditors will disclose management fraud or illegal acts and thus act to control corporate conduct because of the reputational penalties imposed upon them if (1) they fail to act and (2) their failure is discovered. Easterbrook and Fischel (1991) and Prentice (2000) both implied that auditors would engage in a cost-benefit analysis and realize that the potential losses due to reputational impairment exceed the benefits of poor audit work. Murphy and Turek (2015) used economic theory to develop a model of client and auditor payoffs and incentives related to client money laundering activities. They concluded that when the proceeds from money laundering exceed the probability-weighted cost of sanctions, then financial institutions have an incentive to engage in illegal activities. They also concluded that when financial institution management is able to affect the probability of client retention, and consequently auditor non-disclosure, that the financial reward for non-disclosure is greater than the expected cost of reputational impairment, then the auditor has an incentive go along with the client.

Tillman (2009, 370) observed that economists view reputational intermediaries (e.g. auditors) as barriers to corporate fraud and illegal acts while these same intermediaries are viewed by sociologists and criminologists as "key facilitators of fraud". This second view is consistent with Byrne (2002) who noted the perversion of the accounting profession and claimed that auditors and analysts have become players in a game of nods and winks. Tillman (2005, 206) further noted that "the culture of conformity that big accounting firms had traditionally promoted was shifting from stressing adherence to accounting rules to conforming to the new priority of maximizing revenue and pleasing clients."

Audit Firm Tenure and Audit Quality

Auditing research has consistently demonstrated that the probability of financial statement fraud decreases as audit firm tenure increases (George, 2009; Carcello and Nagy, 2004; Myers, Myers and Omer, 2003; Johnson, Khurana and Reynolds, 2002). This effect may arise from a number of factors. Geiger and Raghunandan (2002) found that long-tenured auditors have more in-depth knowledge about the client's financial position and operations than do shorter-tenured auditors. They also found that long-tenured auditors are more efficient. Beck, Frecka and Soloman (1988) found that long-tenure auditors develop more client-specific knowledge and a deeper understanding of their client's operations and risks.

It takes time to develop client-specific knowledge and to be able to benefit from that understanding. Carcello and Nagy (2004) and Johnson, Khurana and Reynolds (2002) found that fraudulent financial reporting is most likely to occur in the first three years of an auditor-client relationship. Auditor abilities to uncover money laundering activities should, in the same way, increase with the length of tenure of the auditor-client relationship.

Auditors have long recognized the importance of independence (Mautz and Sharaf, 1961). The long-term relationships between audit partners and their clients came in to question after the Enron failure and the Sarbanes-Oxley Act (U. S. House of Representatives, 2002) responded by accelerating audit partner rotations from every seven to every five years. The SEC also extended the cooling-off period for lead and engagement quality review partners from two to five years. Daugherty, Dickins, Hatfield and Higgs (2013) conclude that these changes have resulted in an indirect and negative effect on audit quality. Nevertheless, there is a perception that the length of the audit partner-client firm relationship may have an adverse effect on auditor independence and consequently audit quality.

1.03 HYPOTHESES

The relationship between an audit firm and its client may be a long term one. However, Section 203 of the Sarbanes-Oxley Act requires implies that the lead audit partner on an audit engagement must be rotated off after five years (U. S. House of Representatives, 2002). This brings a new audit partner into the audit and forces a new auditor-client relationship. The first hypothesis tested whether subjects expected that changes in audit dynamics would have an effect on the audit partners response to evidence of potential money laundering. In null form, the first set of hypotheses is that:

H_{1a}: Audit partner tenure (new vs. experienced) will not affect expected auditor response to indications of money laundering.

H_{1b}: Audit partner tenure (new vs. experienced) will not affect expected disclosure confidence.

International accounting firms are perceived, by some at least, as being of higher quality and more rigorous. The implication then is that regional firms are not quite as good. The second hypothesis tests the effect of firm type on auditor responses and disclosure confidence.

H_{2a}: Audit firm type (regional vs. international) will not affect expected auditor response to indications of money laundering.

H_{2b}: Audit firm type (regional vs. international) will not affect expected disclosure confidence.

Finally, as noted above, economic analysis indicates that audit fee materiality may affect auditor decisions. If the cost (penalties and reputational impairment) of not responding to evidence of money laundering are less than the cost of losing a client (present value of the future revenue stream) then non-disclosure by the auditor is the wealth maximizing solution. In null form the third hypothesis is:

H_{3a}: Audit fee materiality (not material vs. material at the office level vs. material at the firm level) will not affect expected auditor response to indications of money laundering.

H_{3b}: Audit fee materiality (not material vs. material at the office level vs. material at the firm level) will not affect expected disclosure confidence.

The following section explains how these hypotheses were tested and summarizes the results of the tests.

2.0 DATA AND METHODOLOGY

The purpose of this study was to assess, in an experimental setting, the degree to which audit partner tenure, audit firm type, and client materiality would affect the likelihood that an auditor would reveal potential money laundering activities to client management consistent with AU§319.06. As noted above, the length of an audit partner-client firm relationship may have an adverse effect on auditor independence and audit quality. Audit partner tenure was manipulated in the study by reporting that the partner on the audit of a financial institution was a new partner, the implication being that the partner-client relationship was new, or an experienced partner with an ongoing client relationship. Audit firm type was manipulated by reporting in the cases that the audit firm was a regional or an international firm. Finally client fee materiality was manipulated by reporting the client fees were material to the local office only, to the firm as a whole, or not material at any level. This 2 x 2 x 3 factorial design is summarized in Table 1 below.

Table 01: Experimental design		
Partner Type	***Firm Type***	***Fee Materiality***
New Partner	Regional CPA Firm	Material at the firm and office level
Experienced Partner	International CPA Firm	Material at the office level
		Not material

The factorial design resulted in 12 different cases. Subjects were asked to indicate on a five-point Likert-like scale the degree to which they expected that the audit partner would address potential money laundering issues that had been uncovered over the course of the audit at the appropriate level of audit-client management. Subjects were also asked to indicate, again on a five-point Likert-like scale, their level of confidence that the associated significant internal control weakness would be disclosed in the notes to the financial statements. The cases were randomize across subjects to reduce the risk of hypothesis guessing and systematic response bias to the cases.

2.01 SUBJECTS

Study participants were 203 upper-division undergraduate and graduate students from two institutions, a large public university (146 subjects) and a small, liberal-arts college (57) subjects. Subject demographic measures are summarized in Table 2 below.

Table 02: Subject demographics			
	Total	**Public Institution**	**Private Institution**
n	203	146	57
Current degree program			
Undergraduate	76	54	22
MBA	73	38	35
Master of Accountancy	54	54	0
Undergraduate Major			
Accounting	103	77	26
Economics	8	6	2
Finance	2	2	0
Management	12	9	3
Marketing	9	9	0
Other business	2	2	0
Non-business	67	41	26
Average full-time work experience	5.23 (2.924)	4.75 (6.149)	7.17 (6.687)
Average part-time work experience	3.02 (2.924)	3.11 (2.913)	2.67 (2.986)
Work Experience Field			
Financial services	39	32	7
Manufacturing	16	8	8
Public accounting	7	7	0
Retail	31	24	7
Services	60	34	26
Wholesale/Distribution	9	2	7
Other	41	39	2
Age	28.08 (6.898)	27.68 (6.703)	29.69 (7.517)
Gender			
Male	101	75	26
Female	102	71	31
Career Objective			
Public accounting	66	51	15
Corporate accounting	48	40	8
Governmental accounting	7	7	0
Non-accounting	82	48	34

Demographic variables used as covariates included the subjects' current academic program (undergraduate business, MBA or Masters of Accountancy), undergraduate degree, age, gender, years of full-time and part-time work experience, employment sector, post-graduation career objective (public accounting, corporate accounting, governmental accounting, or non-accounting), and institution (public university or private college).

The subjects were enrolled in undergraduate business programs (76 subjects, 37.4 percent), an MBA program (73 subjects, 36.0 percent), or a Masters of Accountancy program (54 subjects, 26.6 percent). A majority of the subjects reported an undergraduate degree in accounting (103 subjects, 50.7 percent) while a high proportion of the graduate students reported a non-business undergraduate degree (68 subjects, 33.5 percent of the total, 53.5 percent of the graduate students). The overall female/male subject mix was essentially equal with 102 female subjects and 101 male subjects. The most frequently identified career path was non-accounting (82 subjects, 40.4 percent) while public accounting was the second most frequently identified post-graduation career path (63 subjects, 31.0 percent).

2.02 STUDENTS AS SURROGATES

A review of the literature leads to the conclusion that students are adequate surrogates for accounting practitioners in decision-making experiments (Liyanarachchi, 2007). Studies that focused on decision-making, such as this study, reported similarities between students and professionals (Ashton and Kramer, 1980; Houghton and Hronsky, 1993; and Liyanarachchi and Milne, 2005). The accounting literature suggests that an ability to make judgments consistent with professional standards is an important quality of audit decisions (Bedard, 1991). Such knowledge and ability is gained through formal accounting education as well as through modeling the behavior of more experienced professionals in the work place. The students used in this study were highly educated; they were upper-division accounting majors and graduate students. In addition, the use of advanced-level accounting students as surrogates for accounting practitioners is supported in relatively structured decision contexts (Mortenson, Fisher, and Wines, 2012). Therefore, we concluded that the students that were used are adequate surrogates for the purposes of this study.

3.0 RESULTS

Subjects were asked to indicate the degree to which they expected that the audit partner would address potential money laundering issues that had been uncovered over the course of the audit with the management of the audit client, a financial institution (Auditor Response). Subjects were also asked to indicate their level of confidence that the significant internal control weakness would be disclosed in the notes to the financial statements (Decision Confidence). Mean responses by treatment are summarized in Table 3.

Table 03: Mean (Standard Deviation) responses

Treatment	Auditor Response	Disclosure Confidence
Partner type		
New	3.44 (1.099)	3.08 (1.128)
Experienced	3.76 (1.083)	3.39 (1.092)
Firm type		
Regional	3.62 (1.107)	3.19 (1.106)
International	3.55 (1.101)	3.26 (1.062)
Materiality Level		
Not material	3.85 (1.003)	3.32 (1.107)
Office only	3.55 (1.086)	3.24 (1.042)
Firm level	3.39 (1.160)	3.13 (1.107)

As shown in Table 3, subjects felt that the likelihood that the audit partner would discuss the potential money laundering issues was higher when the audit partner was experienced. They also felt that such discussion was more likely when the client fees were not material to either the local office or the firm as a whole. Disclosure likelihood decreased as fee materiality increased.

Subjects' confidence that the issue would be disclosed in the footnotes to the financial statements increased with audit partner experience and with materiality. Thus, it appears that the subjects felt that confronting a client with evidence of a potential illegal act decreased with materiality, and their perception of the likelihood of disclosure increased with materiality.

The data were analyzed using a univariate ANOVA model and the results are summarized in Tables 4 and 5. The general model analyzed was:

$$D_i = Partner_{ij} + Type_{ij} + Material_{ij} + Partner_{ij}\,xType_{ij} + Partner_{ij}\,x\,Material_{ij} + Type_{ij}\,x\,Material_{ij} + Partner_{ij}\,x\,Type_{ij}x\,Material_{ij} + Demo_{ik}$$

Where:

D	= Dependent variable (auditor response or disclosure confidence)
Partner	= Partner type (new vs. experienced)
Type	= Firm type (regional vs. international)
Material	= Materiality level (not material, material at the office level, material to the firm)
Demo	= Demographic variables
i	= Subject
j	= Treatment level
k	= Demographic variable

4.0 RESULTS AND DISCUSSION

The results of the study are presented and discussed in this section. As shown in Table 4 the auditor response ANOVA model had an r-squared of 0.919 and two of the three treatment variables were highly significant. Both partner type (F = 45.713, sig = 0.000) and materiality level (F=35.134, sig = 0.000) were highly significant. In addition, the interaction of partner type and materiality level (F= 3.273, sig = 0.038) was significant. Firm type (F=1.380, sig = 0.24) was not significant nor were the other treatment interactions. Thus H_{1a} and H_{3a} were rejected. H_{2a} was not rejected. The only covariates that were significant were undergraduate degree (F=8.656, sig = 0.003) and work sector (F=20.820, sig = 0.000). None of the other covariates, including the subjects' academic institution were significant.

Table 04: ANOVA – Auditor Response (Tests of Between-Subjects Effects)

Dependent Variable: Response

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Model	30385.783[a]	21	1446.942	1253.590	.000
Undergrad Degree	9.992	1	9.992	8.656	.003
Years FT Work	1.904	1	1.904	1.649	.199
Years PT Work	4.241	1	4.241	3.675	.055
Work Sector	20.820	1	20.820	18.038	.000
Age	.010	1	.010	.009	.926
Gender	1.883	1	1.883	1.632	.202
Career Goal	1.135	1	1.135	.983	.321
Institution	.948	1	.948	.821	.365
Academic Program	1.370	1	1.370	1.187	.276
Partner Type	52.764	1	52.764	45.713	.000
Firm Type	1.593	1	1.593	1.380	.240
Fee Materiality	81.107	2	40.553	35.134	.000
Part * Type	1.382	1	1.382	1.197	.274
Part * Material	7.557	2	3.778	3.273	.038
Type * Material	1.556	2	.778	.674	.510
Part * Type * Material	3.345	2	1.673	1.449	.235
Error	2673.217	2316	1.154		
Total	33059.000	2337			

a. R Squared = .919 (Adjusted R Squared = .918)

As shown in Table 5 below, the disclosure confidence ANOVA model had a r-squared of 0.902 and two of the three treatment variables were highly significant. Again, both partner type (F = 42.623, sig = 0.000) and materiality level (F=7.376, sig = 0.001) were highly significant, and H_{1b} and H_{3b}, in their null forms, were both rejected. Finally, firm type (F=4.103, sig = 0.043) was not significant and so H_{2b}, in its null form, was not rejected. None of the treatment interactions were significant. The only covariates that were significant were years of full-time work experience (F=14.484, sig = 0.000) and work sector (F=9.976, sig = 0.002), age (F=4.618, sig = 0.032), and the subjects' academic institution (F=8.362, sig = 0.004). None of the other covariates, including the subjects' academic institution were significant.

Table 05: ANOVA – Auditor Disclosure Confidence
Tests of Between-Subjects Effects

Dependent Variable: Confidence

Source	Type III Sum of Squares	df	Mean Square	F	Sig.
Model	24388.934[a]	21	1161.378	1013.446	.000
Undergrad Degree	.033	1	.033	.029	.865
Years FT Work	16.599	1	16.599	14.484	.000
Years PT Work	.025	1	.025	.022	.882
Work Sector	11.432	1	11.432	9.976	.002
Age	5.292	1	5.292	4.618	.032
Gender	1.638	1	1.638	1.429	.232
Career Goal	.519	1	.519	.453	.501
Institution	9.583	1	9.583	8.362	.004
Academic Program	.032	1	.032	.028	.867
Partner Type	48.868	1	48.868	42.643	.000
Firm Type	4.702	1	4.702	4.103	.043
Fee Materiality	16.906	2	8.453	7.376	.001
Part * Type	.942	1	.942	.822	.365
Part * Material	2.726	2	1.363	1.190	.305
Type * Material	1.524	2	.762	.665	.514
Part * Type * Material	3.175	2	1.588	1.385	.250
Error	2654.066	2316	1.146		
Total	27043.000	2337			

a. R Squared = .902 (Adjusted R Squared = .901)

Mean responses for selected covariates are shown in Table 6. As shown in Table 6, subjects with undergraduate degrees in non-business fields assessed the likelihood that the audit partner would discuss the potential illegal act with client management at a higher level than did business majors, including accounting majors. There was a significantly less response variable across undergraduate degrees with respect to the disclosure likelihood question.

Undergraduate degree was not significant in the analysis of disclosure confidence responses. However, both years of full-time work experience and work sector were significant. As shown in Table 6, subjects with prior work experience in public accounting assessed the likelihood of disclosure higher than did subjects with work experience in other sectors. In addition, older subjects assessed disclosure likelihood as being higher. Students at the private college were, on average, older than the subjects at the public university and this may explain the significance of the institution covariate. When the disclosure likelihood ANOVA model was run without the institution covariate the r-squared remained unchanged as did the mix of significant and non-significant covariates. However, the F value for age increased from 4.618 (sig = 0.032) to 5.657 (sig = 0.017).

Table 06: Discussion Likelihood and Disclosure Confidence by Selected Covariates Mean and (Standard Deviation)

Covariate	*Value*	*Discussion Likelihood*	*Disclosure Confidence*
Academic Program Level			
	Undergraduate	3.51 (1.146)	3.22 (1.054)
	MBA	3.66 (1.076)	3.24 (1.091)
	M.ACCT	3.59 (1.076)	3.20 (1.118)
Undergraduate Degree			
	Accounting	3.58 (1.123)	3.21 (1.026)
	Economics	3.50 (1.167)	3.04 (1.230)
	Finance	3.39 (1.271)	2.87 (0.537)
	Management	3.49 (1.077)	3.51 (1.089)
	Marketing	3.58 (1.116)	2.90 (1.341)
	Other Business	3.56 (1.058)	3.27 (1.123)
	Non-business	3.82 (1.002)	3.26 (1.132)
Career Goal			
	Public Accounting	3.55 (1.094)	3.19 (1.134)
	Corporate accounting	3.63 (1.125)	3.23 (1.039)
	Governmental/Not-for-profit accounting	3.50 (1.090)	3.03 (1.061)
	Non-Accounting	3.67 (1.106)	3.51 (1.060)
Work Experience Field			
	Financial services	3.58 (1.123)	3.16 (1.038)
	Manufacturing	3.50 (1.167)	3.07 (1.016)
	Public accounting	3.39 (1.271)	3.56 (0.812)
	Retail	3.49 (1.077)	3.34 (1.058)
	Services	3.58 (1.116)	3.14 (1.128)
	Wholesale/Distribution	3.56 (1.058)	3.49 (0.919)
	Other	3.82 (1.002)	3.31 (1.196)

This study disclosed an inverse relationship between the materiality of a client fee to a CPA firm and the perceived likelihood that an auditor partner would discuss a potential illegal act, a money laundering red flag, would be discussed with client management. As the client fee became more material to the CPA firm, subjects felt that a discussion of the issue with client management would be less likely. While surprising, this result is consistent with results of the economic model developed by Murphy and Turek (2015).

While students are not perfect surrogates for experienced auditors, it does raise the question of whether or not auditors take fee materiality into account when they make audit decisions. Auditing standards to do not instruct or even suggest that auditors consider client fee materiality in their decisions in the course of an audit. Future research should seek to determine if such an effect does exist in practice, even at a subconscious level and, if so, how auditors could prevent such an effect. CPA firms may want to take explicit measures to ensure that fee materiality does not affect audit decisions by documenting critical decision processes in their working papers.

The results of this study also demonstrated that audit partner experience is positively related to the likelihood that the auditor would discuss the money laundering red flag with client management. It appears that subjects felt that more experienced auditors would be more likely to discuss a critical issue with management than and inexperienced partner. While this result is not surprising it may indicate that the subjects felt that confidence increased with experience. CPA firms may wish to include a discussion of the importance of open discussions with client management in their training programs for new partners.

This study found a highly significant ($p<.001$) relationship between partner type and fee materiality level and the likelihood of event disclosure, and a significant ($p<.005$) relationship between firm time and event disclosure. Again subjects felt that experienced partners were more likely to disclose the event in question than were new partners. In addition, once again there was an inverse relationship between fee materiality and disclosure confidence; as fee materiality increased the disclosure confidence decreases. Finally, subjects reported a higher level of disclosure confidence when the audit firm was reported to be an international CPA firm.

As above, the effect of fee materiality is the most critical of the reported results. If such a fee bias exists in practice, then there is a risk that auditors will subjugate their decisions to the likelihood of client retention. If a client's fee is material to the firm, at either the office or firm level, then decisions may be made to please the client and thus ensure the continuation of the material audit fee. Auditor disclosure of the issue in question in this study would require that the auditor issue an opinion other than an unqualified opinion and such an action might impair the long-term relationship with the client.

5.0 CONCLUSIONS

This study tests the effects of audit partner tenure, audit firm type and audit fee materiality on subjects expectations that evidence indicating potential money laundering would be discussed by the audit partner with appropriate levels of client management, and the subject's disclosure confidence. The following hypotheses were tests:

H_{1a}: Audit partner tenure (new vs. experienced) will not affect the perceived auditor response to indications of money laundering. (Rejected)

H_{1b}: Audit partner tenure (new vs. experienced) will not affect the perceived disclosure confidence. (Rejected)

H_{2a}: Audit firm type (regional vs. international) will not affect the perceived auditor response to indications of money laundering. (Not rejected)

H_{2b}: Audit firm type (regional vs. international) will not affect the perceived disclosure confidence. (Not Rejected)

H_{3a}: Audit fee materiality (not material vs. material at the office level vs. material at the firm level) will not affect the perceived auditor response to indications of money laundering. (Rejected)

H_{3b}: Audit fee materiality (not material vs. material at the office level vs. material at the firm level) will not affect the perceived disclosure confidence. (Rejected)

It thus appears that both audit partner tenure and fee materiality may affect auditors' decisions to discuss a key audit finding with client management. It also appears that audit partner tenure, and audit fee materiality affected disclosure confidence.

6.0 FUTURE RESEARCH

Future research should address the question of the degree to which, if any, practicing auditors consider the effect of their audit opinion on their long-term relationship with the client and thus client retention.

Students were used as subjects in this study and consequently the results may not be generalizable to practicing auditors. In spite of this limitation the results do raise interesting questions about the interaction of fee materiality and auditor responses to money laundering red flags. In addition, as accounting majors reported lower discussion and disclosure likelihoods than did other subjects, these results may have implications for accounting and auditing education. Lawson (2004) and Nonis & Swift (2001) both reported that students who engage in wrongful and dishonest acts in college continue the same behavior in the workplace. While the decisions made by students in this study were not wrongful or dishonest, they were decisions in materiality levels which may have wrongly affected a professional judgment. Future research should seek to identify the causes of the lower likelihood assessments among accounting majors and see if that effect is long term; that is, does it follow students into practice and do they, as practicing auditors, continue to respond to fee materiality the same way.

7.0 POLICY IMPLICATIONS

Subjects indicated that the likelihood of issue discussion with the client and subsequent disclosure decreased with increased audit fee materiality. From a policy point of view it may be important to auditors to document that key audit decisions were made without taking into account the materiality of the audit fee and the potential loss of the audit client on audit firm revenue. In addition, the results demonstrate that inexperienced audit partners were perceived as being less likely to address key or sensitive issues with client management. Thus audit firms may want to mentor new auditor partners to ensure that those critical discussions do take place. Second partner review would be an appropriate tool to follow-up and ensure that materiality issues did not contaminate audit decisions and that key and critical issues were discussed at the appropriate level with client management.

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