

The Influence of Source Credibility and Attribution of Blame on Juror Evaluation of Liability of Industry Specialist Auditors

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A substantial body of academic research has studied the decision making process of jurors in an audit litigation setting. Several studies explicitly invoke theories of source credibility (Brandon and Mueller 2006, 2008; Buckless and Pearce 1993; Grenier et al. 2012; Sonnier et al. 2012) or attribution of blame (Brandon and Mueller 2006, 2008; Grenier et al. 2013; Kadous 2000, 2001; Kadous and Mercer 2012; Lowe and Reckers 1994; Reffett 2010; Sonnier et al. 2012) to develop hypotheses. This study builds on a pilot study by the authors previously published in this journal and develops a model that examines the interrelationship of source credibility and attribution of blame on juror decision making. This is the first study to demonstrate how each theory separately and jointly contributes to jurors' decisions.

The impact of the characteristics of an audit on juror decisions is of increasing importance as the auditing profession enters the new regime of International Financial Reporting Standards and its anticipated, unchartered litigation environment. Kadous and Mercer (2012) finds that the effect of accounting standard precision on juror decisions depends on both a company's reporting choice and whether it is consistent with industry norms. Grenier et al. (2013) applies responsibility theory from Schlenker et al. (1994) to predict that the effect of standard precision depends on the auditor's technical expertise and whether the auditor uses a judgment aid. They find that when standards are precise,

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generalists are found less negligent compared to technical experts even though their judgments are perceived to be of lower quality. More blame being attributed to the technical expert is consistent with the finding below that jurors attribute greater blame to industry specialists in the event of an audit failure. However, industry specialists are also more credible and we predict and find that source credibility reduces attribution of blame. Our study, therefore, informs the continuing investigation of juror decision making in audit malpractice suits by isolating the effects of credibility and blame attribution.

Using a between subjects experiment of a nationally drawn sample of 464 eligible jurors and structural equation modeling, we use auditor industry specialization to evaluate the impact of source credibility and attribution of blame on jurors' finding of negligence, award of compensatory damages, and award of punitive damages in an audit malpractice lawsuit. Participants in the study assume the role of a juror and evaluate the facts of a case where an audit firm is sued for issuing an unqualified audit opinion a few months prior to a company's bankruptcy. The company that was audited by the firm is a closely-held, privately-owned corporation, and the plaintiff in the suit is a bank that extended a loan to the company in reliance on the unqualified audit opinion. In the case materials, the audit firm is described either as an industry specialist auditor with extensive knowledge and expertise about the client's industry or an audit firm without such knowledge and expertise.

As predicted, we find that jurors view audit firms that are industry specialists as more credible than firms that are not industry specialists. However, jurors also attribute greater blame for an audit failure when the auditor is an industry specialist. The credibility of an industry specialist decreases the propensity of a juror to render a finding of negligence while blame attribution has the opposite effect. Interestingly, our results also show that by

increasing an audit firm's credibility, industry specialization simultaneously and indirectly decreases the blame attributed to the auditor. In a second step, we examine the impact of auditor specialization on the award of compensatory damages and find that only a firm's credibility is a factor in the assessment of damages; lower damage awards are assessed against more credible auditors. In a third step we analyze punitive damages. When a juror determines that an award of punitive damages is warranted, only attribution of blame has an effect on the award level. Higher punitive awards are assessed against auditors to whom greater blame is attributed for the audit failure.

Our study contributes to the literature on juror decision making by establishing how source credibility and attribution of blame separately influence a juror's evaluation of auditor negligence, the award of compensatory damages, and the award of punitive damages. As a matter of law, auditors commit negligence when they fail to conduct an audit using the reasonable care that other auditors would use under the circumstances (Causey 2001; Goldwasser et al. 2010, §4:1.1, §4:1.2). We demonstrate that jurors apply a higher standard of care to industry specialist auditors when evaluating auditor negligence despite being held to the same reasonable professional standard as a matter of law. Other studies have found the standard of care imposed by jurors on auditors to be influenced by the legally extraneous factor of outcome severity (Kadous 2000, 2001; Lowe and Reckers 1994). To counteract this behavior as it relates to industry specialization, attorneys representing industry specialist auditors should consistently emphasize to the jury – in both requesting jury instruction by the trial judge and in their opening and closing statements – that the expertise and experience of an industry specialist auditor does not subject them to a higher legal standard of care when assessing negligence. Prior research has found jury instructions and other debiasing

techniques to be effective in mitigating the effect of extralegal factors on juror decisions (Buckless and Peace 1993; Clarkson et al. 2002; Cornell et al. 2009, Kadous 2001). The trial attorney should emphasize that “justice is blind” while at the same time calling jurors’ attention to the enhanced credibility of the auditor due to its industry expertise.

The remainder of this paper is organized as follows. Section II provides background information and develops the hypotheses tested in this study. Section III describes the methodology used and the results of the study are presented in Section IV. The implications and limitations of the study are discussed in Section V.

II. Background and Development

Audit Malpractice Lawsuits: Legal Standards and the Jurors

Lawsuits against auditors generally arise when an auditor issues an unqualified audit opinion on financial statements that are alleged to have been misstated due to negligence or fraud. Because fraud must be established by evidence of intent to deceive or reckless behavior, most malpractice suits against auditors are based on negligence (Causey 2001; Grubbs and Ethridge 2007). To prevail in a negligence action against an auditor, the plaintiff must prove that (i) the audit firm breached its professional duty of care in performing the audit, (ii) the plaintiff suffered damages, and (iii) there was a causal connection between the defendant’s breach and the plaintiff’s damages. (Restatement Second Torts 1977, §552).

While the specific legal standard may vary by state, generally the plaintiff must establish that the auditor failed to exercise the same reasonable care that a reasonably careful auditor would use under like circumstances (Causey 2001; Goldwasser et al. 2010, §4:1.1, §4:1.2). The reasonable care standard is vague, requiring jurors to make a subjective evaluation regarding whether the auditor conducted the audit below the required standard of care (Kadous 2000).

The trial judge instructs the jury on the legal standard of care jurors must apply in determining whether the audit firm has been negligent after all of the evidence in a case has been heard and the attorney for each side has made his/her closing arguments to the jury. The judge will instruct the jury to base its verdict on the jury instructions and the evidence in the trial record. Our jury trial system is based on the “crucial assumption...that juries will follow the instructions given them by the trial judge” (Tanford 1990, 73). Audit malpractice cases generally involve complex factual issues and the conflicting testimony of expert witnesses. Because of the complexity of these cases and the ill-defined “reasonable standard of care” criteria that must be used in deciding the case, jurors engage in heuristic processing (Brandon and Mueller 2008; Cooper et al. 1996; Kadous 2000) and employ a hierarchy of decision rules (Kadous and Mercer 2012) in reaching their verdict.

Research establishes that jurors consider extraneous factors such as race, marital status, social attractiveness, and other factors in reaching a decision. These factors are referred to as extralegal because, legally, they *should not* be considered in reaching a verdict (Alicke and Zell, 2009). Extralegal factors such as the outcome of an audit failure (Clarkson et al. 2002; Kadous 2000, 2001; Lowe and Reckers 1994), auditor tenure (Brandon and Mueller 2008), client importance (Brandon and Mueller 2006), firm size (Brandon and Mueller 2006; Lowe et al. 2002; Sonnier et al. 2012), and industry specialization (Sonnier et al. 2012) have been found to influence the decision making process of jurors in audit malpractice cases as well.

Source Credibility Impact on Jury Decision Making

The source credibility and attribution of blame theories are based on the tendency of individuals to make judgments and decisions using heuristic decision rules. In the pilot study,

we built on attribution theory to predict that, in the event of an audit failure, jurors would attribute less blame to an industry specialist auditor, as compared to the non-specialist (Sonnier et al., 2012). Attribution theory posits that one's behavior is interpreted by others based on the perceived motives or causes of that behavior (Brandon and Mueller, 2008; Kelley and Michela, 1980). The source credibility theory is supported by research finding that individual judgments and decisions are influenced by the credibility of the information source (Eagly and Chaiken 1993). Source credibility consists of three constructs: source expertise, source bias, and the judge's point of view (Birnbaum and Stegner 1979). The judge is the person (i.e. juror) who combines information provided by the sources to make an overall judgment. Judge bias occurs when the decision maker possesses views that influence whether a report is received as credible. Judge bias is assumed constant in this study.

Relying on Birnbaum and Stegner (1979), Dezoort et al. (2003) developed a model using source expertise and source bias as elements for measuring credibility in an audit environment. "Source expertise" refers to the perceived competence of the auditor while "source bias" refers to the possible bias or personal incentives of the auditor. Dezoort et al. (2003) draw on the source credibility literature which describes source credibility as consisting of expertise and trustworthiness (McGinnies and Ward 1980; O'Keefe 1990; Perloff 1993). Trustworthiness is conceptualized in the model as independence. The model is consistent with DeAngelo's (1981) model that describes audit quality as a function of the likelihood that an auditor will detect a misstatement (competence) and the likelihood that an auditor will report the misstatement (independence).

In the pilot study using student subjects, MANOVA revealed that participants perceived industry specialist auditors to be more competent than non-specialists but they

perceived no significant difference in the independence of auditors who are not specialists versus those who are industry specialists (Sonnier et al. 2012). In this study subjects respond to an additional question regarding perceived objectivity. We expect jurors to view industry specialist auditors as a more credible source than generalist auditors. A significant body of research establishes that investors and other stakeholders have greater confidence in financial statements audited by industry specialists. Companies audited by industry specialists report higher quality earnings than those audited by non-specialists as evidenced by lower absolute discretionary accruals (Krishnan 2003b), decreased earnings management (Balsam et al. 2003; Krishnan 2003a), and larger earnings response coefficients at earnings announcement dates (Balsam et al. 2003). Clients of industry specialist auditors are less likely to restate financial statements, are less likely to have restatements that affect core operating accounts (Romanus et al. 2008), and are less likely to be involved in SEC enforcement actions (Carcello and Nagy 2004). Companies that use an industry specialist auditor have better debt ratings, lower costs of capital, and a lower bid-ask spread than companies audited by non-industry specialists (Almutairi et al. 2009). Analysts have a higher perception of the disclosure quality of companies with industry specialist auditors (Dunn and Mayhew 2004) and their earnings are more reliable in predicting future cash flows (Grambling et al. 2001).

In summary, investors, lenders, and the financial markets perceive that financial data audited by an industry specialist are a more reliable and credible source of information than financial data audited by a non-industry specialist. We therefore expect industry specialist auditors to have greater source expertise than non-specialists in the eyes of jurors. Industry specialization may also increase the reputational capital of the audit firm, making it less likely to compromise its independence and more likely to report violations of generally accepted

accounting standards, financial statement misstatements, and other improprieties (Almutairi et al. 2009). Industry specialist auditors should be seen as more objective in the conduct of the audit because they are less prone to bias. The source bias of an industry specialist auditor should be less than that of a non-specialist, thereby increasing its credibility to jurors.

Based on the foregoing, jurors in auditing malpractice suits should perceive auditors that are industry specialists to be more competent, independent, and objective than non-specialists, making them more credible than non-industry specialists. In turn, the higher level of credibility of industry specialist auditors should decrease the likelihood of adverse juror decisions against them.

The preceding discussion leads to the following hypotheses:

- H1:** *Jurors will find industry specialist auditors to have a higher level of credibility than non-specialists.*
- H2:** *Jurors will be less likely to render an adverse decision against auditors that they perceive to have a high level of credibility.*

Attribution of Blame Impact on Jury Decision Making

The Anglo-American system of justice is based on the notion that one who causes damage to another by his/her wrongful or negligent act should be held responsible for the damages caused by that act. The study of the perceived cause of a negative outcome is described as “attribution theory” (Kelley and Michela 1980, 458). Research in the audit malpractice area establishes that attribution of blame is a factor in the decision making process of jurors. Jurors are more likely to attribute blame to auditors the greater the consequences of the audit failure (Kadous 2000; Lowe and Reckers 1994). When the audit client is financially important to the audit, jurors evaluate the auditor as less objective, more blameworthy, and more deserving of punishment (Brandon and Mueller 2006). As juror

perceptions of the auditor's competence and independence decrease, attributions of blame increase (Brandon and Mueller 2008). Also, jurors are more likely to hold auditors liable for failing to detect fraud when the auditor investigated for the perpetuated fraud as compared to when they did not investigate for the fraud (Reffett 2010). Attribution of blame is reduced for generalist auditors who use judgment aids (Grenier et al. 2013). Finally, in the pilot study, student subjects found auditors more blameworthy when they were not industry specialists (Sonnier et al. 2012).

The pilot results are consistent with a stage theory of blame similar to Shaver's (1985) prescription of blame following causality, responsibility attribution, and then blameworthiness. Alicke (2000) argues that stage theories do not account for psychological processes that result in deviations from expectations and we draw upon his model of culpable control to build our hypotheses.

The culpable control model conceptualizes blame in terms of personal control. The assessment of an actor's control over a harmful event is influenced by the desire to blame someone whose behavior, reputation, or social category has aroused negative reactions. Observers judge how much control the actor exerted by analyzing the structural linkages of volition, causation, and foresight while also spontaneously, relatively, and unconsciously, forming affective reactions to aspects of the events and the people involved. The central question in assessing control and blame attribution is whether the "actor desired, caused, or foresaw the harmful outcome" (Alicke 2000, 559). Kelley and Michela (1980) explain that "attribution is affected by the perceiver's *beliefs*, in this case, about what other actors would do in the same situation" (p. 461). When jurors feel that the actor should have *foreseen* or anticipated the deleterious consequences of his/her act, they are more likely to lay blame on

the actor (Alicke 2000). It is argued that the need to lay blame arises out of the need to feel that similar occurrences can be avoided in the future (Walster 1966; Kadous 2001).

These affective reactions influence blame attribution directly and indirectly by altering observers' structural linkage assessments. For example, a negative effective reaction can influence the assessment of causation by reducing the evidential standards required to attribute blame or by increasing the standards of care by which an act is judged (Alicke 2000; Kadous 2000). In addition to requiring less evidence of intention, negligence, or causality, a juror may exaggerate the evidence regarding the foreseeability of an act's consequence, disregard the justification or explanation for the act, or search for information to support a desired blame attribution (Alicke 2000). Research in an audit litigation setting finds that negative affective reactions of jurors influence their evaluations of auditor negligence (Kadous 2001).

The culpable control model of assessing causation includes the notion of effective causal control which "highlights the fact that observers are attuned not only to the actual consequences of behavior but also to the consequences that could have occurred" (Alicke 2000, 561). This notion is related to counterfactual reasoning research on blame attribution (Roese 1997). Counterfactual reasoning assumes that surprising outcomes motivate thoughts about alternatives whereas culpable control assumes that effective causal control (thoughts about alternatives) is inherent in assessing structural linkages (Alicke 2000; Alicke et al. 2008). Counterfactual theories provide that observers will respond emotionally to unfortunate events and will seek to explain such events based on alternative courses of action that could have averted the negative outcome (Creyer and Gurhan 1997; Reffett 2010). The emotions generated by the wrongful events will result in the natural human inclination to draw causal

inferences and attribute blame for the undesired event (Roese 1997). Thoughts about what could have been done differently to avoid a harmful event can directly affect assessments of blame, create sympathy for the plaintiff in a lawsuit, and increase the harshness of the juror's assessments of defendant liability (Macrae 1992; Roese 1997; Reffett 2010). Drawing on counterfactual reasoning theory, Reffett (2010) finds that evaluators think more intensely about what an auditor could have done differently to detect a fraud when fraud detection procedures were performed relative to when the auditors did not investigate for fraud.

We expect jurors to find industry specialists auditors to be more blameworthy for an audit failure than a non-specialist. Based on the theory of culpable control, jurors would expect an industry specialist to have greater foresight regarding events that could lead to a client's bankruptcy than a non-specialist. When a jury feels that the actor should have foreseen or anticipated the deleterious consequences of his/her act, it is more likely to lay blame on the actor (Alicke 2000). In attributing blame, jurors will think about alternative acts or decisions that the industry specialist auditor could, and should, have taken in conducting the audit. The result will be increased blame being attributed to the industry specialist auditor for the audit failure.

The preceding discussion leads to the following hypothesis:

H3: *Jurors will be more likely to attribute blame for an audit failure to an industry specialist auditor than a non-specialist.*

The attribution of blame literature recognizes that observers of wrongdoing spontaneously evaluate the desirability of each information item, whether favorably or unfavorably (Alicke 2000). Blame is ascribed by the observers' assessment of evidence regarding intention and deeds and by spontaneous evaluations of extralegal factors including

those associated with social attractiveness such as likability, reputation and background (Alicke and Zell 2009). Jurors may have a positive response to a defendant because he/she is socially attractive or because they approve of the values the defendant's behavior reflects, resulting in a decreased attribution of blame (Alicke et al. 2008). Brandon and Mueller (2008) establishes that jurors attribute less blame to an auditor who is perceived to be competent. As discussed above, auditors with greater knowledge and expertise about the audit client's industry will be perceived as socially attractive and more credible than a non-specialist. We propose that the social attractiveness and greater credibility of an industry specialist auditor will result in less blame being attributed to it in an auditing malpractice case as compared to a non-industry specialist.

The preceding discussion leads to the following hypothesis:

H4: *Jurors will attribute less blame to an auditor with a higher level of credibility.*

We predict that industry specialization will increase attribution of blame because jurors will perceive that the industry specialist auditor could have foreseen and avoided the negative outcome of the audit failure (Hypothesis 3). At the same time, jurors will view the industry specialist as more credible (Hypothesis 1) which will reduce the blame attributed to the audit firm for the audit failure (Hypothesis 4). Therefore, we predict that industry specialization will (1) directly increase blame attribution due to the juror's perceived foreseeability of the audit failure (culpable control / counterfactual reasoning) and (2) indirectly decrease blame attribution because of the enhanced credibility of an industry specialist (social attractiveness). In turn, the higher level of blame attributed to an audit firm for an audit failure, the more likely it is that jurors will render an adverse verdict against the firm (Alicke et al. 2008; Brandon and Mueller 2006).

The preceding discussion leads to the following hypothesis:

H5: *Jurors will be more likely to render an adverse verdict against auditors to whom they attribute a high level of blame for the audit failure.*

The model that we develop in this study is depicted in Figure 1.

[Insert Figure 1: Hypothesized Model about here]

III. Methodology

Design

We used a single-factor, between-subjects design to study the effects of industry specialization on source credibility, attribution of blame, finding of negligence, and award of compensatory and punitive damages. In the industry specialization condition, the auditor is described as (i) auditing a large number of other companies in the same industry as the audit client, (ii) having a substantial amount of knowledge about the client's industry, and (iii) being an expert about the client's industry. In the non-industry specialization condition, the auditor is described as (i) auditing only one other company in the same industry as the audit client, (ii) having a limited amount of knowledge about the industry, and (ii) not being an expert about the industry.¹

Participants

The participants were members of a national online panel administered by Zoomerang. Prequalification questions were included at the beginning of the questionnaire related to the eligibility of participants to serve on a jury in a federal district court in the United States (i.e.

¹ The instrument also contained a manipulation of the size of the audit firm, which had no significant effect on any of the dependent variables. Therefore, firm size was omitted from the paper (e.g. Brandon and Mueller 2008, Footnote 7).

registered voter in the U.S., 18 years of age or older, and not a convicted felon). Participants were only allowed to continue if they were jury eligible. Additionally, participants were asked if they were either a licensed Certified Public Accountant or attorney. Licensed CPAs and attorneys were not allowed to proceed as participants because they would not likely be selected to serve on a jury in an accounting malpractice action.

Six hundred and three individuals meeting these criteria responded completely to the online survey. Four hundred and sixty four usable responses were retained. Participants had to identify the correct specialization category of the audit firm to remain in our analysis set. One hundred and thirty nine surveys were removed because of incomplete information provided by respondents or participants failing to correctly respond to a recall question regarding a primary audit firm specialization facet of the case. Table 1 sets forth the demographic data of the participants in our study.

[Insert Table 1: Demographics about here]

The case was administered using an online survey instrument and a random generator ensured that our conditions were randomly assigned. Effective randomization among the two treatment groups was successful as measured by demographic variables. The Kruskal-Wallis test applied to gender (Chi-Square=2.19, $p=.15$), age (Chi-Square=.014, $p=.91$), employment (Chi-Square=.003, $p=.96$), marital status (Chi-Square=.395, $p=.53$), household income (Chi-Square=.059, $p=.81$), mutual fund ownership (Chi-Square=.002, $p=.96$), and prior jury service (Chi-Square=.882, $p=.35$) revealed no statistically significant differences between the groups.

Materials and Procedure

Participants were provided with an audit litigation case along with jury instructions for assessing negligence, compensatory damages, and punitive damages. The litigation scenario

for this study is a modified version of the case used in Lowe and Reckers (1994), Clarkson et al. (2002), Brandon and Mueller (2006, 2008) and Sonnier et al. (2012). In the case, participants were asked to assume the role of a juror and evaluate whether an audit firm was negligent in issuing an unqualified audit opinion for the financial statements of a company that went bankrupt shortly after the opinion was issued.

The company in the case was a toy manufacturer that was a closely-held, non-public company. During the course of the audit, the auditor's standard audit procedures revealed certain negative business conditions being faced by the company that could impair its ability to continue. The audit firm was also made aware that its audit report would be relied upon by a bank in deciding whether to extend a loan to the company. After evaluating information regarding the negative business conditions and the company's plans to overcome them, the audit firm concluded that it did not have substantial doubt about the company's ability to continue to exist for at least another year. Accordingly, an unqualified opinion was issued by the audit firm. Shortly thereafter, the bank extended a substantial loan to the company. Several months later the company filed for bankruptcy.

In the case, the bank sued the audit firm for negligence. The bank argued that the audit firm should have issued a going concern opinion and that it would not have extended the loan to the company had a going concern opinion been issued. The audit firm argued that it followed appropriate professional standards and judgment in auditing the financial statements of the company.

Participants in the study were first provided the audit litigation scenario to read at their own pace. After the participants completed reading the factual pattern, they were provided jury instructions and asked to decide whether the audit firm was negligent in the performance

of the audit. Participants were also asked how confident they were in their decision regarding their negligence verdict using a seven-point Likert scale. Participants that found the audit firm negligent were then asked to indicate the amount that they would award to the bank as compensatory damages. After participants completed the verdict portion of the survey instrument, they were asked to respond to additional questions that included demographic information, manipulation checks, and other variables of interest. After a participant completed reading the case or providing responses to a section of the survey instrument, the participant was not permitted to return to the case, a previously completed section of the survey, or to change prior responses.

Source Credibility, Attribution of Blame and Verdict Measures

We investigate five constructs in this study: three dependent variables and two mediating variables. The dependent variables in this study are the participants' evaluations of negligence verdict rendered by the participant (Verdict), compensatory damages awarded against the audit firm by the participant if it found the audit firm negligent (Compensatory Damages), and punitive damages awarded against the audit firm by the participant if it found the audit firm negligent (Punitive Damages).

Verdict. The first dependent variable, Verdict, measured the likelihood that a juror would render a verdict against the audit firm by finding it negligent in the conduct of the audit (Verdict). Participants were first asked to render a dichotomous negligence verdict (guilty or not guilty of negligence) and then asked about the level of confidence in their verdict using a seven-point Likert scale with end points of "not at all confident" and "completely confident." The two questions were combined to create a 14-point liability scale where one represents complete confidence in a "not guilty" verdict and seven represents complete confidence in a

“guilty” verdict (Brandon and Mueller 2006, 2008; MacCoun 1993). Because the 14-point scale generated a bimodal distribution, we converted it to a seven-point scale resulting in a normal distribution.² Prior research has shown this measure more predictive of juror voting during deliberation than the simple dichotomous measure (Stasser and Davis 1981).

Compensatory Damages. In an actual jury trial, when the jury renders a verdict finding an audit firm negligent it must next determine the amount of compensatory damages to be awarded the plaintiff. To assist in this task, jurors are given jury instructions by the trial judge that describes the manner of determining the award of compensatory damages. Therefore, participants in our study that rendered a verdict against the audit firm were next asked to indicate the amount of compensatory damages they would award the plaintiff (Compensatory Damages). Similar to jurors in an actual case, participants were provided instructions on the award of compensatory damages at this point in the instrument³.

Punitive Damages. Participants who rendered a verdict finding the audit firm negligent were also asked whether the defendant should be held liable for punitive damages. As in an actual jury trial, the participants were given a jury instruction regarding the award of punitive damages.⁴ If a participant answered that punitive damages should be awarded, he/she

² Levels one through three of the seven-point scale are indicative of a strong belief that the audit firm was not negligent; level four represents jurors that were unsure of whether the firm was negligent or not; and levels five through seven represent jurors that were strongly convinced that the jurors were negligent.

³ Instruction provided regarding compensatory damages: Compensatory damages are awarded to compensate the plaintiff for losses incurred as a result of the defendant's actions. Such damages shall not include any interest, which would have been earned by the bank on its loans, attorney's fees, or costs associated with the collection of the loan.

⁴ Instruction provided regarding punitive damages: If you find that First Bank's loss was attended by circumstances of fraud or malice, then you may also assess a reasonable sum as punitive damages. Punitive damages, if assessed, are to be assessed as punishment of the defendant, and as an example to others. Fraud means an intentional misrepresentation, deceit or concealment of a material fact known to the defendant with the intention on the part of the defendant of causing injury. Malice means despicable conduct, which is carried on by the defendant with a willful and conscious disregard for the safety of others. A person acts with conscious disregard of the safety of others when he is aware of the probable dangerous consequences of his conduct and willfully fails to avoid those consequences.

was then asked to state the amount of punitive damages they would award the plaintiff (Punitive Damages).

Source Credibility. Our first mediating variable is source credibility. DeAngelo (1981) described audit quality as a function of auditor competence and auditor independence. The source credibility theory identifies source expertise (perceived competence) and source bias (perceived independence) as basic elements that affect the credibility of an information source (DeZoort et al. 2003). In our study, the juror's perceived source credibility of the audit firm was measured by asking three questions regarding:

- the extent to which respondents believed the audit firm was independent of the client on a scale of 1 (not at all independent) to 7 (completely independent);
- the audit firm's competence in performing its duties in the audit of its client on a scale of 1 (not at all competent) to 7 (extremely competent); and
- the extent respondents believed that the audit firm was objective during the audit of the client on a scale of 1 (not at all objective) to 7 (extremely objective).

Factor analysis showed that the three measures loaded on one dimension allowing us to create an overall measure of source credibility. Cronbach's alpha for the three-item construct was 0.75, exceeding the threshold of 0.70 required to accept construct reliability (Churchill, 1991).

Attribution of Blame. Our second mediating variable is attribution of blame. Similar to the approach taken in Lowe et al. (2002, 193), we asked participants the following three questions to measure their belief regarding the blameworthiness of the auditor:

- To what extent do you blame the audit firm for the bank's loss?

- How responsible is the auditor for the bank's loss?
- To what extent do you believe that the audit firm caused the bank's loss?

Participants responded to these questions on a seven-point Likert scale. Factor analysis showed that the three measures loaded on one dimension allowing us to create an overall measure of juror attribution of blame. Cronbach's alpha for the three-item construct was 0.95, far exceeding the threshold of 0.70 required to accept construct reliability (Churchill 1991).

We checked that our multi-item measures of source credibility and attribution of blame showed discriminant validity with factor analysis. The resulting two factor solution showed no cross-loadings and the two factors explained more than 67 percent of the variance (see Appendix).

IV. RESULTS

To test whether our conditions worked, we ran a multivariate analysis of variance (MANOVA) with our dependent and mediating variables. After testing for normal distribution and the equality of covariances across our *a priori* firm specialization groups⁵, we find significant multivariate main effects for firm specialization (Wilk's lambda = .90, F = 12.41, $p < .001$).⁶ As illustrated in Figure 1 the study's hypothesized relationships are interconnected. The research model in Figure 1 is multiple-step mediator model since two

⁵ First we tested the distributive values of our data and found that skewness and kurtosis stayed within acceptable ranges of between -1 and 1 (Hair et al 2014). The only exception was "Attribution of Blame" which indicated a slightly flatter distribution (Kurtosis = -1.195). Given the approximate normal distribution, we tested the null hypothesis that the observed covariance matrices of the dependent variables are equal across our two firm specialization groups. The Box M test statistic again stays above the cut-off value of $p < 0.001$ (Box's M = 18.104; F = 2.986; $p < .006$) and we have no reason to reject the null hypothesis that the two covariance matrices are equal.

⁶ As noted in Footnote 1, our instrument included a firm size manipulation. There are no significant main effects for Firm Size (Wilk's lambda = .97, F = 1.43, $p < .20$) and there is no significant interaction between Firm Specialization and Size (Wilk's lambda = .98, F = 0.83, $p < .54$). Therefore, the firm size condition was eliminated from the study (e.g., Brandon and Mueller 2006, Footnote 7).

mediators are considered for the effects from auditor specialization to the three outcome variables (verdict, compensatory and punitive damages) and one of the mediators (source credibility) is allowed to causally affect the other mediator (blame attribution). Thus we used ordinary least square regression utilizing the mediation analysis technique advocated by Preacher and Hayes (2004). This technique is superior to Baron and Kenny's mediation analysis in terms of controlling for measurement error (Holmbeck 1997; Hoyle and Kenny 1999; Kline 1998) as it enables exploring possible mediation effects in terms of bootstrapping (Preacher and Hayes 2004; Kline 1998; Hoyle and Kenny 1999) and allows for a more powerful tests of mediation (Preacher and Hayes 2004). We used 1000 bootstrap samples at 95% confidence interval for our analysis.

Verdict. We first evaluate our Verdict dependent variable. Our model exhibits acceptable fit with an $R^2=.62$. Specialization has a significant positive effect on source credibility (H1: $b=.63$, $p<.001$), which in turn has a statistically significant negative effect on verdict (H2: $b=-.30$, $p<.001$) and attribution of blame (H4: $b=-.97$, $p<.001$). Specialization also has a statistically significant positive effect on blame attribution (H3: $b=.62$, $p<.001$). Finally, attribution of blame has a statistically significant positive impact on verdict (H5: $b=.61$, $p<.001$). The results support all hypotheses as to the outcome variable verdict.

To assess the indirect effects, we applied the bootstrapping bias-corrected confidence interval procedure to our mediation model (Preacher and Hayes, 2008; Cheung and Lau, 2008; Zhao et al. 2010). The bootstrapping procedure allows us to evaluate significance and compare different mediators in the model. The advantage of the bootstrap method is a stronger accuracy of confidence intervals and no normality assumptions (Preacher and Hayes, 2008).

Results show that all three indirect effects between specialization and verdict are significant. Source credibility mediates the effect of specialization on verdict with an overall reducing effect. Attribution of blame mediates the effect of specialization on verdict with an overall increasing effect. And both, source credibility and blame attribution, sequentially mediate the specialization effect on verdict in an overall reducing outcome. Interestingly, the total effect ($b=-0.18$; $p<0.35$) for all indirect paths shows no significance, indicating that the different indirect paths compensate each other.

The results of the path analysis with verdict as the dependent variable are set forth in Table 3, Panel A.

[Insert Table 3: Results about here]

Compensatory Damages. Next we examine the effects on compensatory damages. We removed all observations that did not find the auditors negligent in the conduct of the audit and analyzed the remaining two hundred and five data points. Our new model has a reduced R-squared of 0.125.

Specialization positively effects source credibility ($H1: b=.17, p<.38$) but is no longer significant. Source credibility has a negative effect on compensatory damages ($H2: b=-.18, p<.35$), yet is also insignificant. However, source credibility still has a significant negative impact on attribution of blame ($b=-0.27; p<0.002$). In addition, specialization positively effects attribution of blame ($H3: b=.36, p<.05$) and attribution of blame positively effects compensatory damages ($H5: b=.10, p<.005$). Our results support Hypotheses 3, 4, and 5, but do not find support for Hypotheses 1 and 2, in regard to the compensatory damages model.

Results for compensatory damages show that only the indirect effect between specialization and verdict with blame attribution as the mediator is significant. No mediation

through source credibility takes place. Interestingly, the total effect of specialization through blame onto compensatory damages is significant at $p < 0.009$.

The results of the path analysis for compensatory damages are set forth in Table 3, Panel B.

Punitive Damages. We narrowed our dataset further by removing all observations that did not find the auditors liable for punitive damages and analyzed the remaining one hundred and nine data points as to Punitive Damages. The new model only has an R-squared of 0.04. While all direct effects still showed the appropriate signs, only one relationship remained significant. Attribution of blame was positively related to punitive damages at $p < 0.004$, supporting hypothesis 5. None of the indirect paths between specialization and punitive damages were significant and the total effect between specialization and outcome, while negative ($b = -0.18$), also remained insignificant at $p < 0.35$.

The results of the path analysis for compensatory damages are set forth in Table 3, Panel C.

[Insert Figure 2: Models based on results about here]

V. Discussion, Conclusion, and Limitations

The Anglo-American system of justice is based on the idea that jurors will base their verdict on the evidence properly before them applying the legal standards and instructions given to them by the trial judge. However, research has shown that a number of biasing, extralegal factors influence the decision making process of jurors in criminal and civil actions. While many studies use the attribution of blame and source credibility theories to explain factors that influence juror decision making, this is the first study in the accounting field to

segregate and separately analyze their impact on jurors. This is important because it provides insight into the mind of jurors, enabling attorneys and the parties they represent in audit malpractice suits to better plan their litigation strategy. We examine the source credibility and attribution theories in the context of industry specialist auditors.

We establish that industry specialization affects both the assessment of an audit firm's credibility and blame attribution by jurors. Industry specialist auditors are viewed as more credible than non-industry specialist auditors by jurors. By increasing their credibility in the eyes of jurors, industry specialization *indirectly* decreases the blame attributed to auditors for an audit failure and the propensity of jurors to find industry specialist auditors negligent. Although the standard of care applicable to industry specialist auditors and non-industry auditors is the same as a matter of law, jurors attribute greater blame to industry specialist auditors for an audit failure. The practical consequence is that jurors *in fact* impose a higher standard of care on industry specialist auditors than on non-industry specialist auditors. The increased attribution of blame increases the likelihood that a juror will find an industry specialist negligent.

A different pattern emerges when it comes to the award of compensatory damages. Jurors are asked to determine the amount of damages to be awarded to the plaintiff in a malpractice suit only if the audit firm is determined to have been negligent. Jurors are instructed to award compensatory damages of an amount necessary to place the defendant in the same position that it would have been in had the act of negligence not occurred (Causey 2001; Goldwasser et al. 2010). We establish that industry specialization indirectly decreases the amount of compensatory damages awarded to the plaintiff by increasing the credibility of industry specialist auditors. Attribution of blame did not influence the award of compensatory

damages. While this pattern is beneficial to the industry specialist auditor, it indicates that jurors consider the credibility of the audit firm in assessing damages. This is a factor that, as a matter of law, should not enter in the jury's assessment.

Again we see a different pattern when jurors are asked to assess punitive damages in an audit malpractice case. Punitive damages are rare in civil negligence actions and many jurisdictions do not permit an award of punitive damages in an audit malpractice case.⁷ An award of punitive damages is generally permissible in a civil action only if a jury finds that the defendant acted with fraud or malice. Punitive damages are awarded as a punishment and to deter others from engaging in similar conduct. In our study, source credibility was not a factor in the award of punitive damages by jurors. However, the greater the blame attributed to the audit firm, the larger the amount of punitive damages awarded.

This study provides a better understanding of the influence of source credibility and blame attribution, and their interaction, on the jury decision making process. From a practical standpoint it provides useful information to trial counsel and audit firms involved in audit malpractice lawsuits. Trial counsel for an audit firm should emphasize to the jury, and offer evidence demonstrating, the expertise of the audit firm as it relates to the particular audit or industry. Increased credibility should decrease the blame attributed to the audit firm and the risk of a finding of negligence. It should also decrease the amount of compensatory damages awarded.

There is a danger in emphasizing the firm's expertise. Jurors may reason that the audit firm should have foreseen or anticipated the audit failure, or conjure up alternate decisions or actions that the audit firm could (and should) have taken to avoid the audit failure, resulting in

⁷ Anderson and Maccoun (1999), Golwasser et al. (2010), and Shroyer (1991) regarding a discussion of punitive damages in civil suits.

greater blame attribution due to the firm's expertise. To counteract this, the audit firm's trial counsel should emphasize in open and closing arguments that the same standard of care applies to the audit firm regardless of its level of expertise. This same point could also be made with expert witnesses for the defendant and in cross-examining expert witnesses for the plaintiff. Additionally, trial counsel can request the trial judge to include a jury instruction covering this point (e.g., Clarkson et al. 2002; Kadous 2001; Lowe and Reckers 1994).

Our study has several limitations. First, the amount of information provided to participants in the study was much less than would be received by a juror in an actual jury trial. The materials evaluated by the participants were also substantially less complicated than the evidence a juror in an actual auditing malpractice case would encounter. Second, in an actual case, members of a jury reach a decision as a group after discussing the case in the confidential setting of the jury deliberation room. While research establishes that first ballot votes can predict jury verdicts to a high degree (Kadous and Mercer 2012; MacCoun, 1993; Sandys and Dillehay, 1995), the fact that jury decision making is a group deliberative process raises the question of whether the results of our study generalize to actual jury trials. Another juror decision making process limitation of the study could be that it did not evaluate the possible impact of expert witness testimony on the decision making process (DiGabriele, 2008; 2011). Fourth, the study addresses the impact of industry specialization only in the setting of failure to issue a going concern opinion. In addition, the survey instrument was administered online making it possible for participants to be influenced by others in completing the survey instrument.

Jury research studies often rely either on the source credibility and attribution of blame theories to explain juror decision making. Our results demonstrate that source credibility and

attribution of blame may in fact interact in producing a juror's decision in the context of an industry specialist auditor versus a non-industry specialist. The influence and interaction of source credibility and blame attribution should be examined in other accounting or audit malpractice scenarios, such as a tax malpractice or consulting scenario, or an audit failure where the experience level of the auditor assigned to the job varies. Another interesting question is whether a curative instruction as suggested in this article would neutralize or decrease the impact of blame attribution on juror's negligence decisions.

In addition, future research could evaluate the impact of the industry specialization of audit firms in contexts other than the failure to issue a going concern opinion. For example, the impact of industry specialization on juror decision making for failure to detect fraud or the misstatement of financial statements could be evaluated to provide further information in this area.

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Table 1: Demographic Data for Participants

Attribute	Count	Percent
Gender:		
Male	222	47.8
Female	242	52.2
Age:		
18 to 34 years of age	138	
35 to 49 years of age	155	
50 to 64 years of age	102	
65 years of age and above	69	
Marital Status:		
Married	253	54.5
Single, Never Married	103	22.2
Widowed	18	3.9
Separated or Divorced	59	12.7
Living with Partner	31	6.7
Employment:		
Full-time (31 hours or more per week)	236	50.8
Part-time (30 hours or less per week)	56	12.1
Not employed	172	37.1
Household Income:		
Less than \$20,000	55	8.8
\$20,000 to \$39,999	121	26.0
\$40,000 to \$59,999	114	24.6
\$60,000 to \$79,999	79	17.1
\$80,000 to \$99,999	38	8.1
\$100,000 and greater	57	12.3
Currently Mutual Fund:		
Yes	48	39.0
No	75	61.0
Currently Own Real Estate:		
Yes	222	47.8
No	242	52.2
Prior Jury Service:		
Yes	154	33.0
No	310	66.8

Table 2: Means, Standard Deviation and Correlations

Variables	No Specialization			Specialization		
	1	2	3	1	2	3
Panel A: Verdict						
1 Source Credibility	4.40 <i>1.14</i>			5.04 <i>1.28</i>		
2 Attribution of Blame	-.56***	3.65 <i>1.66</i>		-.57***	3.75 <i>1.94</i>	
3 Negligence Verdict	-.50***	.76***	3.98 <i>1.73</i>	-.66***	.75***	3.86 <i>1.81</i>
Panel B: Compensatory Damages						
1 Source Credibility	3.88 <i>1.03</i>			4.16 <i>1.16</i>		
2 Attribution of Blame	-.10	4.89 <i>1.14</i>		.002	5.29 <i>1.10</i>	
3 Compensatory Damages	-.10	.03	2.59M <i>2.54M</i>	-.33***	.20**	2.9M <i>1.6M</i>
Panel C: Punitive Damages						
1 Source Credibility	3.85 <i>0.99</i>			4.00 <i>1.30</i>		
2 Attribution of Blame	.15	5.18 <i>1.05</i>		.11	5.55 <i>1.00</i>	
3 Punitive Damages	.28*	.31**	.93M <i>1.20M</i>	-.01	.41***	1.17M <i>1.31M</i>

Notes: Diagonal shows means and standard deviation in italics.
*** Correlation is significant at the 0.01 level (2-tailed).
** Correlation is significant at the 0.05 level (2-tailed).
* Correlation is significant at the 0.10 level (2-tailed).

Table 3: Results – Regression Coefficients

	Parameters		Name	β	
Panel A: Verdict					
H1	Firm Specialization	→	Source Credibility	0.63	***
H2	Source Credibility	→	Negligence Verdict	-0.30	***
H3	Firm Specialization	→	Attribution of Blame	0.62	***
H4	Source Credibility	→	Attribution of Blame	-0.97	***
H5	Attribution of Blame	→	Negligence Verdict	0.61	***
Mediation	Firm Specialization	→	Negligence Verdict		
through	Source Credibility			-0.11	*
through			Attribution of Blame	0.38	*
through	Source Credibility	&	Attribution of Blame	-0.37	*
Panel B: Compensatory Damages					
H1	Firm Specialization	→	Source Credibility	0.08	
H2	Source Credibility	→	Compensatory Damages	-124K	
H3	Firm Specialization	→	Attribution of Blame	0.36	*
H4	Source Credibility	→	Attribution of Blame	-0.27	**
H5	Attribution of Blame	→	Compensatory Damages	360K	**
Mediation	Firm Specialization	→	Compensatory Damages		
through	Source Credibility			-20K	
through			Attribution of Blame	131K	**
through	Source Credibility	&	Attribution of Blame	-16K	
Panel C: Punitive Damages					
H2	Firm Specialization	→	Source Credibility	-0.07	
H2	Source Credibility	→	Punitive Damages	92K	
H3	Firm Specialization	→	Attribution of Blame	-0.07	
H4	Source Credibility	→	Attribution of Blame	0.32	
H5	Attribution of Blame	→	Punitive Damages	406K	**
Mediation	Firm Specialization	→	Punitive Damages		
through	Source Credibility			-7K	
through			Attribution of Blame	132K	
through	Source Credibility	&	Attribution of Blame	2K	

Notes: *** p < 0.001 ** p < 0.05 * p < 0.10

Appendix: Exploratory Factor Analysis for Multi-Item Measures

	Attribution of Blame	Source Credibility
To what extent do you blame Smith & Watkins for First Bank's loss?	0.92	
To what extent do you believe Smith & Watkins, CPAs, caused First Bank's loss?	0.92	
How responsible is Smith & Watkins for First Bank's Loss?	0.92	
To what extent do you believe that Smith & Watkins was objective during the audit of Atlantis?		0.79
To what extent do you believe that Smith & Watkins was independent of Atlantis?		0.81
How competent did you perceive Smith & Watkins to be in performing its duties in the audit of Atlantis?		0.74
	Eigenvalues	3.70
	% Variance Explained	61.68
	Coefficient Alpha	0.95

Note: VarimaxRotation Method with Kaiser Normalization.

Figure 1: Conceptual Framework

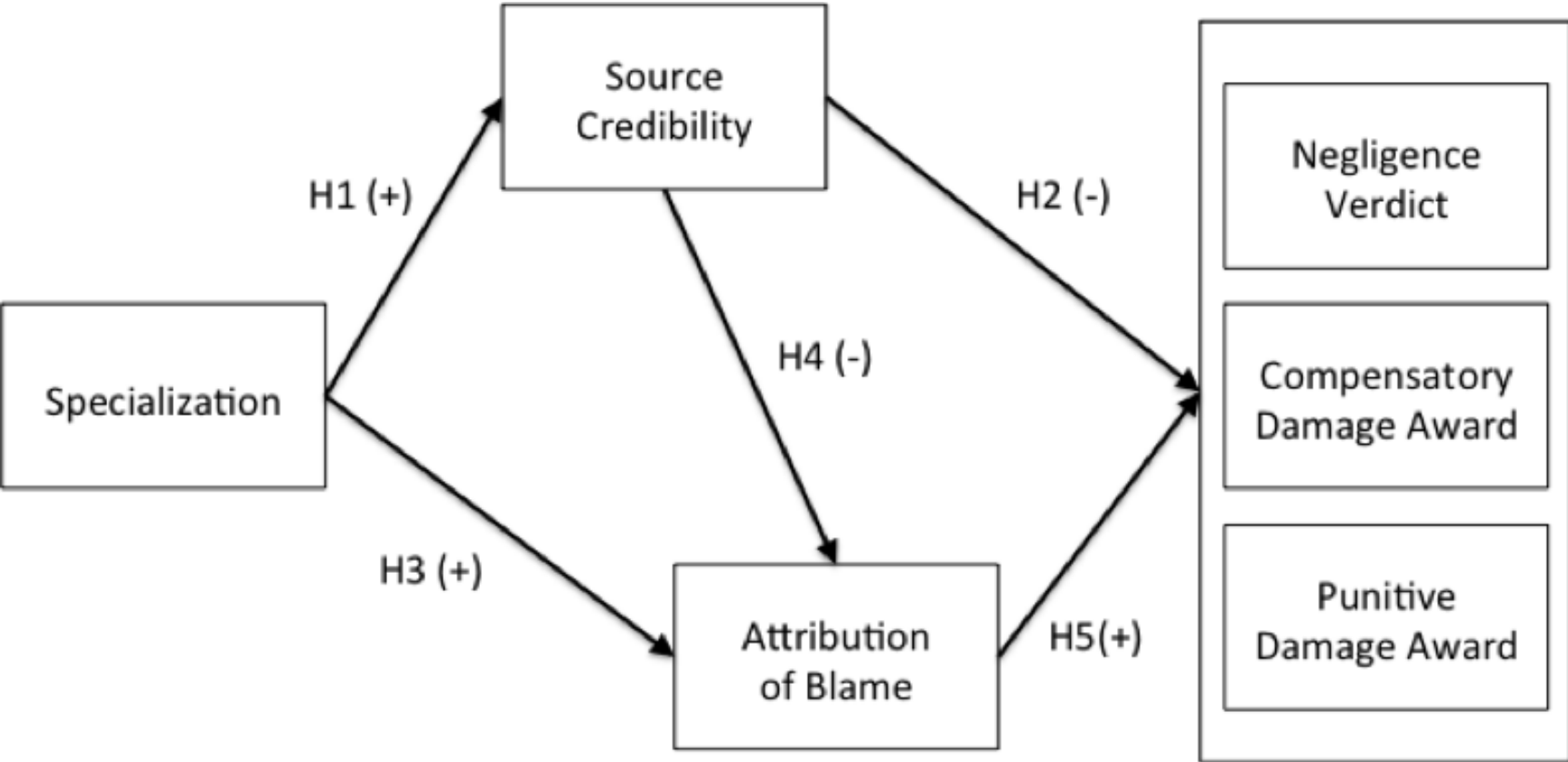
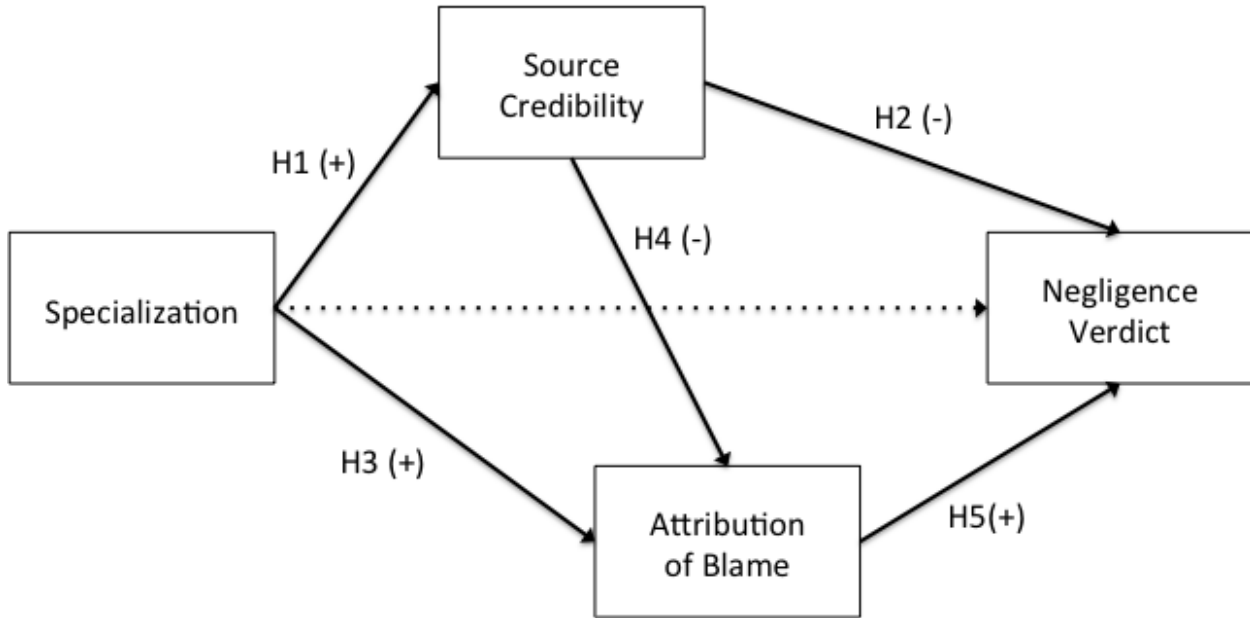
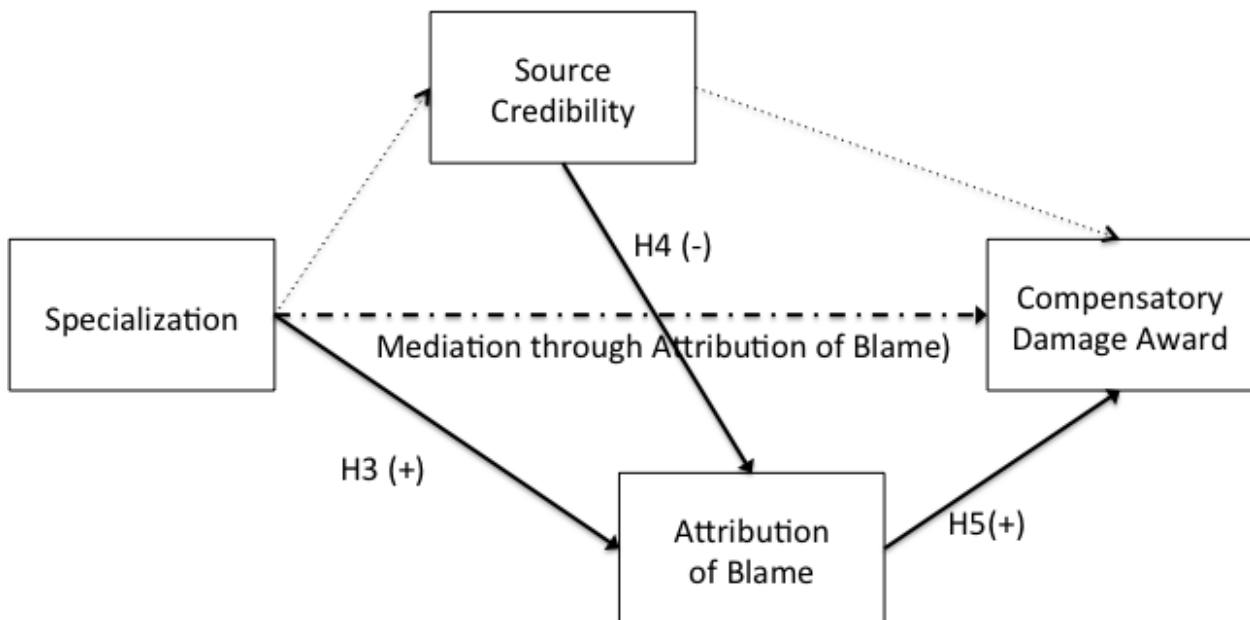


Figure 2: Resulting Models with 3 Panels

Panel A – Negligence Verdict



Panel B – Compensatory Damages [\$]



Panel C – Punitive Damages [\$]

