Negotiations in Audit Processes

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Abstract

English: This cumulative dissertation consists of three full empirical investigations based on three separate collections of data dealing with the phenomenon of negotiations in audit processes, which are combined in two research articles. In the first study, I examine internal auditors' views on negotiation interactions with auditees. My research is based on 23 semi-structured interviews with internal auditors (14 in-house and 9 external service providers) to gain insight into when and about what (RQ1), why (RQ2), and how (RQ3) they negotiate with auditees. By adapting the Gibbins et al. (2001) negotiation framework to the context of internal auditing, I obtain specific process (negotiation issue, auditor-auditee process, and outcome) and context elements that form the basis of my analyses. Through the additional use of inductive procedures, I conclude that internal auditors negotiate when they face professional and non-professional resistance from auditees during the audit process (RQ1). This resistance occurs in a variety of audit types and audit issues. Internal auditors choose negotiations to overcome this resistance primarily out of functional interest, as they cannot simply instruct auditees to acknowledge the findings and implement the required actions (RQ2). I find that the implementation of the required actions is the main goal of the respondents, which is also an important quality factor for internal auditing. Although few respondents interpret these interactions with auditees as negotiations, all respondents use a variety of negotiation strategies to create value (e.g., cost cutting, logrolling, and bridging) and claim value (e.g. positional commitment and threats) (RQ3). Finally, I contribute to empirical research on internal audit negotiations and internal audit quality by shedding light on the black box of internal auditor-auditee interactions. The second study consists of two experiments that examine the effects of tax auditors' emotion expressions during tax audit negotiations. In the first experiment, we demonstrate that auditors expressing anger obtain more concessions from taxpayers than auditors expressing happiness. This reveals that taxpayers interpret auditors' emotions strategically and do not respond affectively. In the second experiment, we show that the experience with an auditor who expressed either happiness or anger reduces taxpayers' post-audit compliance compared to the experience with an emotionally neutral auditor. Apparently, taxpayers use their experience with an emotional auditor to rationalize later noncompliance. Taken together, both experiments show the potentially detrimental effects of positive and negative emotion expressions by the auditor and point to the benefits of avoiding emotion expressions. We find that when auditors avoid emotion expressions this does not result in fewer concessions from taxpayers than when auditors express anger. However, when auditors avoid emotion expressions this leads to a significantly better evaluation of the taxpayer-auditor relationship and significantly reduces taxpayers' post-audit noncompliance.

Abstract

Deutsch: Diese kumulative Dissertation besteht aus drei vollständigen empirischen Untersuchungen, welche auf drei separaten Datenerhebungen basieren, die sich mit dem Phänomen von Verhandlungen in Prüfungsprozessen befassen und in zwei Forschungsartikeln zusammengefasst sind. In der ersten Studie untersuche ich die Ansichten von Innenrevisoren über Verhandlungsinteraktionen mit Geprüften. Meine Untersuchung stützt sich auf 23 halbstrukturierte Interviews mit internen Revisoren (14 in-house Revisoren und 9 externe Dienstleister), um einen Einblick zu gewinnen, wann und worüber (RQ1), warum (RQ2) und wie (RQ3) sie mit Geprüften verhandeln. Durch die Anpassung des Bezugsrahmens zu Verhandlungen von Gibbins et al. (2001) an den Kontext der Innenrevision, erhalte ich spezifische Prozess- (Verhandlungsgegenstand, Prüfer-Geprüften-Prozess und Ergebnis) und Kontextelemente, die die Grundlage für meine Analysen bilden. Durch den zusätzlichen Einsatz induktiver Verfahren komme ich zu dem Schluss, dass Innenrevisoren verhandeln, wenn sie während des Prüfungsprozesses mit professionellem und nicht-professionellem Widerstand seitens der Geprüften konfrontiert sind (RQ1). Dieser Widerstand tritt bei einer Vielzahl von Prüfungsarten und Prüfungsgegenständen auf. Interne Revisoren greifen in erster Linie aus einem funktionalen Interesse auf Verhandlungen zur Überwindung dieses Widerstands zurück, weil sie die Geprüften nicht einfach anweisen können, Feststellungen anzuerkennen und geforderte Maßnahmen umzusetzen (RQ2). Ich zeige weiterhin, dass die Umsetzung geforderter Maßnahmen das Hauptziel der Befragten internen Revisoren ist, welches wiederum ein wichtiger Einflussfaktor für die Qualität der internen Revision ist. Obwohl nur wenige Befragte die Interaktionen mit den geprüften Stellen als Verhandlungen interpretieren, wenden alle Befragten eine Vielzahl von Verhandlungsstrategien an, um Werte zu schaffen (z.B. durch Kostenreduzierung, „Logrolling“ und Überbrückung) und Werte zu beanspruchen (z.B. durch Positionsverpflichtungen und Drohungen) (RQ3). Diese Studie leistet einen Beitrag zur empirischen Forschung über Verhandlungen und die Qualität der internen Revision, indem sie Licht in die „Blackbox“ der Interaktionen zwischen internen Revisoren und Geprüften bringt. Die zweite Studie besteht aus zwei Experimenten, in denen die Auswirkungen emotionaler Äußerungen von Betriebsprüfern bei Verhandlungen im Betriebsprüfungskontext untersucht werden. Im ersten Experiment wird gezeigt, dass Prüfer, die Ärger während Verhandlungen zum Ausdruck bringen, mehr Zugeständnisse von den Steuerpflichtigen erhalten als Prüfer, die Freude zum Ausdruck bringen. Dies zeigt, dass die Steuerpflichtigen die Emotionen der Prüfer strategisch interpretieren und nicht affektiv reagieren. Das zweite Experiment zeigt, dass die Erfahrung mit einem Prüfer, der entweder Freude oder Ärger in einer Verhandlung geäußert hat, die Steuerehrlichkeit von Steuerpflichtigen nach der Prüfung verringert, verglichen mit der Erfahrung mit einem emotional neutralen Prüfer. Die Steuerpflichtigen scheinen ihre Erfahrungen mit einem emotionalen Prüfer zu nutzen, um ihre spätere Steuerunehrlichkeit zu rationalisieren. Zusammengenommen zeigen beide Experimente die potenziell nachteiligen Auswirkungen positiver und negativer Emotionen des Prüfers und deuten auf die Vorteile der Vermeidung von Emotionsäußerungen hin. Wir stellen zudem fest, dass die Vermeidung von Emotionsäußerungen durch die Prüfer nicht zu weniger Zugeständnissen seitens der Steuerpflichtigen führt, als wenn die Prüfer Ärger äußern. Wenn die Prüfer jedoch Emotionen vermeiden, führt dies zu einer signifikant besseren Bewertung der Steuerpflichtigen-Prüfer-Beziehung und zu einer signifikanten Verringerung der Steuerunehrlichkeit durch die Steuerpflichtigen nach der Prüfung.

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INTRODUCTORY SUMMARY

This cumulative dissertation consists of three full empirical investigations based on three separate collections of data dealing with the phenomenon of negotiations in audit processes, which are combined in two research articles. Beginning with Antle and Nalebuff (1991), Gibbins et al. (2001), and Beattie et al. (2001), the view that external auditors negotiate with auditees has gained acceptance in the academic auditing community over the past two to three decades and has led to the publication of numerous empirical studies documenting negotiations between external auditors and audited clients (e.g., Bennett et al. 2015; Gibbins et al. 2005; Gibbins et al. 2010; Hatfield et al. 2008; Hatfield et al. 2022; McCracken et al. 2008; Perreault et al. 2017). As a result, the financial statements are viewed as a joint product of the external auditors and the audited entities, even though the audited entities are formally responsible for preparing the financial statements (Antle and Nalebuff 1991).

Negotiations in other audit contexts, such as tax audits or internal audits, by contrast, have received very little attention in empirical research. Moreover, previous empirical findings on financial statement negotiations with external auditors are not readily transferable to these contexts due to the contextual nature of accounting research in general (Gibbins et al. 2005; Libby and Luft 1993) and accounting negotiation research in particular (e.g., Beattie et al. 2000, 2001, 2004; Gibbins et al. 2001; Salterio 2012).

For example, unlike external auditors, internal auditors are often part of the audited entity themselves and report primarily to senior management and the audit committee rather than to interested members of the public outside the audited entity, as external auditors do with their audit opinions. In order to fulfill its various tasks, the internal audit function (IAF) primarily informs the relevant parties within the company about its auditing and consulting activities (The Institute of Internal Auditors (IIA) 2017, Performance Standard 2440), but is not authorized to issue instructions to auditees in order to initiate any changes.

In contrast to internal audits and external audits of financial statements, tax audits play an important role for the government in detecting and deterring non-compliance with tax rules. However, due to considerable tax law ambiguity, the outcome of a tax audit is often negotiated between the tax auditor and a representative of the audited entity (henceforth termed "taxpayer"). The context of tax audits is therefore different from that of internal audits and external financial audits, as the outcome of a tax audit may have an immediate and serious negative impact on the taxpayer's cash flow, which is not the case with internal audits and external financial audits, at least not in the short term.

The differences between these audit contexts, as well as the scarcity of empirical research on negotiation in tax auditing and internal auditing, represent research gaps that this dissertation seeks to address.

The first study examines negotiations in the internal audit context and, in particular, internal auditors' views on negotiation interactions with auditees during audit processes. Although there are numerous practice articles (e.g., Jeffords et al. 1993; Johnson et al. 1998; Pastor 2007; Pickett and Pickett 2010, 376, 855, 942; Seago 2017) and some preliminary empirical evidence on internal audit negotiations (e.g., Brown and Fanning 2019; Christensen 2022; Fanning and Piercey 2014; Funnell and Wade 2012), the body of research on internal audit negotiations is very limited. At the very least, this literature indicates that internal auditors negotiate with auditees to reach consensus and that various strategies and tactics have varying degrees of success in convincing auditees to adopt the internal auditors' perspective.

I pursue two general research goals with this study. The first research goal of this study is to develop an analytical framework for internal audit negotiations that explicitly considers process and contextual factors derived from the existing literature on internal audit and external audit negotiations as well as from the general negotiation literature. This analytical framework not only systematizes the literature on process and contextual factors in internal audit negotiations, but also serves as a theoretical foundation for the subsequent interview study. I base the development of this analytical framework on the "Three-Element Accounting Negotiation Process Model" by Gibbins et al. (2001) and adapt it accordingly to the context of internal auditing. In doing so, I identify a variety of factors at both the process level (negotiation issue, auditor-auditee process, and negotiation outcome) and the context level (external conditions and constraints, interpersonal context, and capabilities of the negotiating parties) that potentially influence internal audit negotiations.

Using this analytical internal audit negotiation framework, I address my second research goal, which is to examine when and about what (RQ1), why (RQ2), and how (RQ3) internal auditors negotiate. To explore internal auditors' perspectives on negotiations in practice and to achieve my second research goal, I conduct 23 semi-structured interviews with internal auditors (14 in-house and 9 external service providers). I use a semi-structured interview approach because this is "[…] a particularly effective means of gathering data when the subject matter of the interview is complex, sensitive or not well understood" (Matthews and Ross 2010, 227).

The results for RQ1 show that internal audit negotiations, in contrast to external audit negotiations, rarely occur during financial statement audits, but rather during other types of audits that cover a wide range of audit issues. Moreover, internal auditors negotiate when the auditees show resistance, which manifest itself in various professional and non-professional arguments. The types of professional arguments that auditees present to internal auditors also give them an indication of whether the objection is more directed at the findings, the proposed actions, or the audit itself. Particularly when the auditees' arguments are non-professional—often indicating heated discussions—it is difficult for internal auditors to discern whether it is unfounded resistance or an indication of deeper problems that need to be addressed.

The results for RQ2 show the reasons why respondents choose to resolve disagreements with auditees through negotiation and the goals they seek to achieve by doing so. Respondents negotiate their disagreements with auditees out of a functional interest, i.e. they expect to (better) achieve their own goals in this way. The reason for this is that internal auditors do not have a more effective tool at their disposal to persuade auditees to change their behavior, as they do not have the authority to issue instructions. Therefore, internal auditors rely on the cooperation of auditees to initiate corrective actions "to add value and improve an organization's operations" and "to enhance and protect organizational value" (The Institute of Internal Auditors (IIA) 2017, Definition and Mission of Internal Audit). This is a significant difference from external auditing, as internal auditors are not only tasked with detecting irregularities, but also with initiating changes in the audited areas so that errors can be corrected, problems be solved, and added value can be created.

The results for RQ3 show that all respondents (consciously or unconsciously) use negotiation strategies and tactics, although most internal auditors are not aware that resolving disagreements with auditees can be characterized as negotiation. In addition, all respondents are preparing for upcoming negotiations. While all respondents mentioned substantive, audit-related preparations, strategic preparations beyond that varied, in some cases considerably. Nonetheless, some respondents prepare for negotiations by, for example, anticipating possible arguments from the auditees through role-playing, becoming aware of their negotiation limits, and strategizing the order of points to be discussed in the closing meeting.

In terms of negotiation strategies, all respondents use value-creating (e.g., cost-cutting, logrolling, and bridging) and value-claiming strategies (e.g., positional commitments and threats) to persuade auditees (RQ3). To achieve integrative outcomes, respondents often promote an open exchange of information and mutual trust through focused preliminary discussions with auditees or their supervisors, as well as respectful and objective treatment of auditees (also referred to as procedural fairness). One of the most popular integrative tactic is to adapt wording in the audit report without abandoning the actual findings and required actions (cost cutting). This is achieved, for example, by providing additional reasons for a negative audit finding in the audit report or by also presenting positive findings. Another tactic is to adjust the timeframe for implementing corrective actions to address auditees' concerns about whether they can implement them with the given capacity.

Despite the many descriptions of value-creating strategies, respondents also described and used strategies aimed at claiming values, particularly through positional commitments and threats. These tactics relied on expertise and authority within or outside the IAF and were intended to underscore internal auditors' determination to stand firm or persuade auditees to relent.

This study provides an initial, deeper understanding of how internal auditors view and behave in negotiations with auditees in the audit process. "As such, this study is primarily descriptive. While it was guided by the [self-developed analytical framework for internal audit negotiations which is based on current theory on internal and external audit negotiations], thus providing results informed by theory, it does not test theory" (Gibbins et al. 2007, 418). Nonetheless, this study contributes to current research in internal auditing as well as audit negotiation and identifies future research needs. The development of an analytical internal audit negotiation framework and insights from the field into when and about what, why, and how internal auditors negotiate represent the main contribution of this study. In this way, this study sheds light on the black box of interactions between internal auditors and auditees and confirms that negotiations are quite common in internal auditing and are different from negotiations in external auditing. This may be relevant to the practice of internal auditing, as many internal auditors rarely interpret interactions with auditees as negotiations and are rarely trained in negotiations. Specific negotiation training could therefore potentially improve the effectiveness of an IAF and thus internal audit quality.

In terms of empirical research, the elements of the analytical negotiation framework contribute to research on internal audit negotiations by highlighting future research needs, as each process and contextual element may have an impact on internal audit negotiations and is thus potentially open to investigation. For example, this study shows that internal auditors often use both integrative and distributive negotiation strategies. In this context, future research could explore whether this approach is always beneficial, whether only distributive approaches should be used in certain situations, or whether there are situations in which internal auditors should avoid negotiation altogether. Furthermore, the findings on internal audit negotiations provide important insights into the concept of internal audit quality (see Trotman and Duncan 2018), as these negotiations can affect multiple quality components simultaneously: the *audit process* in which the negotiation interaction occurs, the *audit output* in the form of the agreed-upon audit report, including findings and recommendations, and the *audit outcome* in the form of value added to the organization.

The second study is co-authored with Kay Blaufus and Ulfert Gronewold and consists of two full empirical investigations based on two separate experimental data collections. However, for publication strategy reasons, these were combined into one study. Experiment one examines the effects of tax auditors' emotions on taxpayers' concession making during tax audit negotiations, while experiment two examines the effects of tax auditors' emotions on post-audit compliance of taxpayers, i.e., after the negotiation with an emotionally acting tax auditor.

Given that the outcome of a tax audit negotiation may have immediate and severe financial consequences (in the form of back tax payments) for the taxpayer, while at the same time the generation of back tax payments is a crucial success factor in the evaluation of the auditor's work (Alissa et al. 2014), tax audit negotiations are likely to elicit a relatively high level of emotional involvement of the participating parties. When emotions of one party become perceivable for the other party during the negotiation, e.g., via verbal remarks or non-verbal mimics and gestures, they may influence the negotiation process and ultimately its outcome. Thereby, it does not matter whether these emotions emerge subconsciously or are being used strategically (Barry 1999; Kopelman et al. 2006). Moreover, prior research suggests that emotional experiences in negotiations may have longer-term consequences beyond negotiated outcomes (Wang et al. 2012). Thus, the emotional experience during a tax audit may also affect subsequent tax planning behavior.

We focus on happiness and anger as two discrete, basic emotions. The theory of basic emotions postulates that these emotions are distinct from each other, fulfill an evolutionary role by helping us deal with fundamental life-tasks (Ekman 1972, 1992a, 1992b), and that other non-basic emotions can be described as mixtures of the basic emotions (Ekman 1992a). Moreover, anger and happiness may likely occur in tax audit negotiations. For instance, during the negotiation process, tax auditors may openly display anger about the proceedings or behave friendly to ease a tense situation.

From a purely rational point of view, emotional cues from a tax auditor should neither influence taxpayers' concessions nor taxpayers' post-audit behavior because such cues do not alter the existing bargaining range or the underlying substantive conditions. However, on the one hand, the auditor's emotions may spill over to taxpayers and might thus cause *affective* taxpayer responses as predicted by social contagion theory (Levy and Nail 1993). On the other hand, the *Emotion As Social Information* (EASI) model (Van Kleef 2009) considers that the tax auditor's emotions may not only cause *affective* responses but could also cause *inferential* processes. According to the EASI model, the interpretation of another person's emotional expressions via inferential processes depends on the individual's information processing motivation—or epistemic motivation[1]—which in turn is influenced by the context wherein the interpretation takes place (Van Kleef et al. 2004b; Van Kleef 2014).

Based on the EASI model and the specific tax audit context, we argue that a tax auditor's display of emotions (happiness, anger, or neutral) will influence a taxpayer's behavior in predictable ways via inferential processes (i.e., via a strategic interpretation of the tax auditor's emotions by the taxpayer). During a tax audit negotiation, a tax auditor's signs of anger are expected to call for the taxpayer's change in his/her current behavior, i.e., to concede to the tax auditor to appease him/her and prevent the negotiation from failing.[2] In contrast, a tax auditor's signs of happiness are likely to be interpreted by the taxpayer as a sign of weakness because this kind of interpretation seems to be typical in competitive settings (Sinaceur and Tiedens 2006; Van Kleef et al. 2004a, 2004b, 2010).

To test our predictions, the first experiment examines the influence of tax auditors' emotions on taxpayers' concessions in a tax audit negotiation, for which 86 business administration students participated in a computer-based, incentivized economic experiment. Participants had to negotiate the amount of five warranty provisions with a simulated tax auditor. While the negotiation algorithm of the auditor is the same in all treatments, we manipulate the emotional statements of the auditor. Using a 3x1 between-subjects design, we differentiate between the expression of happiness, anger, and the absence of emotional statements (neutral treatment).

We find that expressing anger increases taxpayers' concessions compared to expressing happiness. These findings are in line with the predictions derived from the *Emotion As Social Information* (EASI) model (Van Kleef 2009) and its underlying theory as adapted and applied to the

1 Epistemic motivation is "[…] the desire to develop and maintain a rich and accurate understanding of the world, including the negotiation task" (Van Kleef et al. 2004b, p.511). In this context, epistemic motivation is also used as a synonym for information processing motivation (Van Kleef 2014).

2 Conceding can be seen as the most reliable strategy for complying with the other party's needs (Ben-Yoav and Pruitt 1984).

tax audit negotiation environment. On average, participants who negotiated with an angry tax auditor conceded 13.1% more than participants who negotiated with a happy tax auditor. Notably, however, participants who negotiated with an angry tax auditor did not concede significantly more than participants who negotiated with an emotionally neutral tax auditor. This means that in tax audit negotiations, which involve a high degree of uncertainty for both parties and a high epistemic motivation of the negotiation opponents, something as natural as showing emotion will be interpreted strategically by the other party and thus influence the outcome of these negotiations and, in particular, the resulting tax payments.

Further analysis revealed that the tax auditor's emotional expressions also influenced the participants' evaluation of their relationship with the tax auditor. We find that in both, the *HAPPINESS* treatment and the *NEUTRAL* treatment the mean ratings of the relationship to the auditor are positive, whereas participants' mean rating in the *ANGER* treatment is rather negative. This is noteworthy because the tax authority responsible for tax collection, the Revenue Agency, might be interested in improving their public image to enhance the trust in and cooperation with the Agency (OECD 2013). Therefore, a good relationship with the auditees during field audits might also be valued by the Revenue Agency.

In summarizing the first experiment, we find that tax auditors who behave emotionally neutral obtain taxpayer concessions that are not significantly lower than auditors expressing anger and higher than auditors expressing happiness. Moreover, auditors who avoid emotional expressions receive better ratings on the relationship dimension than auditors expressing anger and only slightly worse ratings than auditors expressing happiness. Thus, looking only at the negotiation setting, showing no emotions seems to be the superior alternative from a tax auditor's point of view.

The second experiment examines the effect of tax auditors' emotions during a tax audit negotiation on taxpayers' subsequent tax compliance after the audit. From a purely rational point of view, emotional cues from a tax auditor should neither influence taxpayers' concessions nor taxpayers' post-audit behavior because such cues do not alter the existing bargaining range or the underlying substantive conditions. However, on the one hand, the auditor's emotions may spill over to taxpayers and might thus cause *affective* taxpayer responses as predicted by social contagion theory (Levy and Nail 1993). As positive own emotions have been shown to increase the willingness to make concessions (e.g., Baron 1990), taxpayers facing a happy (angry) auditor may make more (less) concessions. Following this line of reasoning, post-audit tax compliance may also be affected by induced taxpayer emotions. People usually behave in such a way that they avoid (seek) negative (positive) emotions (Moreno et al. 2002). Because positive (negative) taxpayer emotions may compensate (amplify) negative feelings linked with non-compliance such as guilt and shame, positive (negative) emotions may decrease (increase) post-audit tax compliance (Fochmann et al. 2023).

On the other hand, the *Emotion As Social Information* (EASI) model (Van Kleef 2009) considers that the tax auditor's emotions may not only cause *affective* responses but could also cause *inferential* processes. In particular, if taxpayers interpret the auditor's emotion expressions as informative signals about the government's tax enforcement policy, the expression of happiness may signal that tax non-compliance is not a severe problem for the government and that the government does not exert rigorous coercive power, whereas the expression of anger may signal that the government takes an extremely strict stance, possibly even tending to exploit its citizens and to abuse its power. In both cases, the emotional signals could serve as a rationalization strategy to justify an increasing tax planning aggressiveness, so that individuals are able to maintain a positive self-view in terms of being a moral person despite engaging in actually immoral behavior (Mazar et al. 2008). This suggests that auditor expressions of both anger and happiness may decrease taxpayers' post-audit tax compliance.

Whether affective responses or inferential processes dominate in a tax audit setting is ultimately an empirical question. Therefore, we conduct a second experiment with 80 business administration students participating in another computer-based, incentivized economic experiment with a 3x3 mixed within-between-subjects design. After having completed the same negotiation as in the first experiment (i.e., either with an angry, happy, or neutral tax auditor), participants complete three tax compliance tasks relating to the tax returns of the following year where they have to decide on how much tax-deductible operating expenses they want to deduct from their revenues and also if they are willing to set this amount to a level that they know is illegal. These tax compliance tasks are manipulated within participants where participants (a) expect the *same* (*happy*, *angry*, or *neutral*) *tax auditor* they just met to inspect their tax returns of the following year in case of a tax audit, (b) expect *a different, unknown tax auditor* to inspect their tax returns of the following year in case of a tax audit, or (c) expect *no tax audit* for their tax returns of the following year.

The results of the second experiment show that the auditor's expression of both anger and happiness significantly reduces the probability that taxpayers choose a non-aggressive deduction level by 13 to 19 percentage points. Moreover, even if participants know that their tax return will not be audited the emotion effects remain. In this case, the probability of illegally evading taxes is between 16 to 26 percentage points higher for participants that had previously negotiated with an angry or happy tax auditor instead of an emotionally neutral auditor. The probability to evade taxes in the *ANGER* and *NEUTRAL* treatments does not depend on whether participants expected to be audited by the same or an unknown tax auditor. However, the probability to evade taxes was significantly lower in the *HAPPINESS* treatment (average marginal effect: 32 percentage points) if participants expected to meet a different auditor rather than the same auditor with whom they had previously negotiated. This suggests that participants in the *HAPPINESS* treatment believed that different auditors would treat taxpayers differently and that their own experience with a happy auditor might not reflect the average auditor's behavior.

Experiment 2 shows that both the expression of anger and happiness by the tax auditor result in detrimental effects on taxpayers' post-audit tax compliance, but raise the question of why both opposing emotion expressions increase taxpayers' tax planning aggressiveness. We show that neither the effects of the auditor's emotions on the participants' own emotions can explain this result, nor can possible effects on the perceived interactional fairness explain this result. However, because incentives and the opportunity to evade taxes are the same in all three treatments, these results are in line with the interpretation that taxpayers use the emotional behavior of tax auditors to rationalize their tax non-compliance if we assume that fraud is determined by incentives, opportunities, and rationalization (for the so-called fraud-triangle see Murphy and Dacin (2011), Trompeter et al. (2013), Morales et al. (2014)).

Taken together, the two experiments provide causal evidence that tax auditors' emotion expressions affect the outcome of tax audit negotiations and post-audit tax compliance. While the first experiment shows that a tax auditor's expression of happiness leads to less concessions by the taxpayer during audit negotiations, the second experiment reveals an additional disadvantage of expressing happiness: experiencing negotiations with a happy auditor results in greater tax aggressiveness by the taxpayer after the audit. Because the expression of both anger and happiness by the tax auditor results in detrimental effects on taxpayers' post-audit tax compliance our results point toward the advantageousness of an emotionally neutral auditor behavior. Avoiding emotional expressions does not lead to significantly less concessions by the taxpayer (but more concessions than when expressing happiness), and at the same time does lead to a positive evaluation of the relationship. In fact, the relationship in a negotiation with an emotionally neutral auditor is evaluated only slightly worse than in a negotiation with a happy auditor and significantly better than in a negotiation with an angry auditor. Moreover, an emotionally neutral auditor behavior avoids the negative effects on tax compliance.

Our study contributes to previous research as follows. First, we contribute to the recently growing research on the effects of emotions in accounting (Geng and Kalargiros 2021; Repenning et al. 2022). Second, we contribute to prior tax negotiation and compliance research by providing the first study that investigates the effect of tax auditors' emotions. Third, using the methods of experimental economics, we add to negotiation research in accounting (e.g., Gibbins et al. 2001; Hatfield et al. 2010; Sanchez et al. 2007) by adjusting a negotiation algorithm that was previously only used in psychology research to a specific accounting context. We also contribute to research by examining whether the predictions of social contagion theory or the EASI model explain negotiation behavior in a tax audit setting. Our findings are clearly in line with the EASI model and call for more research on what conditions symmetrical and asymmetrical responses to others' emotions.

Even though we analyze a tax audit setting, it is likely that similar conditions might be present in other accounting contexts and therefore inform accounting researchers in general about the potential influence of others' emotions and about the potential merits of avoiding emotions. From an auditor's perspective, our study indicates that showing no emotion can combine the advantages of showing anger (more auditee concessions) and of showing happiness (better relationship) and even protect the auditor from potential disadvantages (decreased compliance) in future periods associated with showing emotions of happiness and anger.

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INTERNAL AUDIT NEGOTIATIONS –
THE INTERNAL AUDITOR'S PERSPECTIVE

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Abstract

In this study, I examine internal auditors' views on negotiation interactions with auditees. My research is based on 23 semi-structured interviews with internal auditors (14 in-house and 9 external service providers) to gain insight into when and about what (RQ1), why (RQ2), and how (RQ3) they negotiate with auditees. By adapting the Gibbins et al. (2001) negotiation framework to the context of internal auditing, I obtain specific process (negotiation issue, auditor-auditee process, and outcome) and context elements that form the basis of my analyses. Through the additional use of inductive procedures, I conclude that internal auditors negotiate when they face professional and non-professional resistance from auditees during the audit process (RQ1). This resistance occurs in a variety of audit types and audit issues. Internal auditors choose negotiations to overcome this resistance primarily out of functional interest, as they cannot simply instruct auditees to acknowledge the findings and implement the required actions (RQ2). I find that the implementation of the required actions is the main goal of the respondents, which is also an important quality factor for internal auditing. Although few respondents interpret these interactions with auditees as negotiations, all respondents use a variety of negotiation strategies to create value (e.g., cost cutting, logrolling, and bridging) and claim value (e.g. positional commitment and threats) (RQ3). Finally, I contribute to empirical research on internal audit negotiations and internal audit quality by shedding light on the black box of internal auditor-auditee interactions.

1. Introduction

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations […]" (The Institute of Internal Auditors (IIA) 2017, Definition of Internal Auditing). Its mission is "to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight" (The Institute of Internal Auditors (IIA) 2017, Mission of Internal Audit). To accomplish this mission, the internal audit function (IAF) is not empowered to issue instructions to the audited entities, but to inform the responsible parties of the results of their activities (The Institute of Internal Auditors (IIA) 2017, Performance Standard 2440). The work of internal auditors is even more challenging when one considers that they must critically review processes within the organization in which they are employed (Calvin 2021).

In the event of an unresolved disagreement between internal auditors and their auditees, the IIA's former Practice Advisory 2410-1 no. 12 recommends that internal auditors disseminate an audit report that includes both, the auditors' and the auditees' views and the reasons for their disagreement (The Institute of Internal Auditors (IIA) 2013).[3] Instead of disseminating this audit report throughout the organization, all the way up to senior management or the board of directors, and risking further negative consequences (e.g., further deterioration of the relationship with the auditees, a modification of valid audit findings, or an impediment to ongoing and future audits), the IAF and the auditees also have the opportunity to cooperatively resolve their disagreements up front.

A constructive way to overcome these disagreements is through negotiations, which have been reported repeatedly in the literature on internal audit practice over the years (e.g., Burke and

[3] Since 2015, the IIA's International Professional Practices Framework (IPPF) no longer consists of the Practice Advisories, but of the newly created Implementation Guidance. Nevertheless, the Practice Advisories formed the basis for the Implementation Guidance. However, the Implementation Guidance no longer describes how to proceed in the event of disagreements between the internal auditor and the auditee or how to communicate those findings. I therefore refer to the former Practice Advisory 2410-1.

Kovar 1999; Dittenhofer et al. 2010, 67–74; Jeffords et al. 1993; Johnson et al. 1998; Kelly 2017; Pastor 2007; Pickett and Pickett 2010, 376, 855, 942; Seago 2017). Resolving these disagreements is relevant to empirical research and company stakeholders because the IAF is part of the firm's corporate governance system (Cohen et al. 2010; Ege 2015; Prawitt et al. 2009; Trotman and Duncan 2018), various stakeholders use the IAF on a regular basis (Bame-Aldred et al. 2013; Ege 2015; Trotman and Trotman 2015), the quality of internal audit is most likely influenced by the success or failure of these negotiations (Trotman and Duncan 2018) and the failure to communicate effectively and appease agitated parties can lead to pressure within the organization to change valid audit findings (Calvin 2021). While empirical research on negotiations between external auditors and clients is well established (e.g., Gibbins et al. 2001; Hatfield et al. 2010; McCracken et al. 2008; Perreault et al. 2017; Salterio 2012), there is little empirical research on internal audit negotiations and on the practice of internal audit in general (Roussy and Perron 2018), and several recent calls for research on this topic illustrate this shortage (Brown and Fanning 2019; Roussy and Perron 2018; Trotman and Duncan 2018).

Among these exceptions is experimental empirical research on internal audit negotiations, which has already shown that auditees are more likely to comply with internal auditors' demands in negotiations when internal auditors offer professional favors (e.g., waiving a minor investigation or an immaterial finding) while adopting a participatory audit approach (Brown and Fanning 2019) or are both likable and present their arguments in a thematically organized manner (Fanning and Piercey 2014). Burton et al. (2012) show that management can also be influenced in the context of consulting engagements. Even when management has initial preferences for how to address an operational issue, internal auditors' recommendations that are inconsistent with management's preferences often lead to a change in management's final decision (Burton et al. 2012). According to Christensen's (2022) single-case field study, the IAF and the auditees primarily negotiate the draft audit memo, which includes the IAF's description of observations, its recommended actions and deadlines, and the prioritization of those observations. Even in the public sector, internal auditors negotiate audit findings and their relationship with the auditee, as shown by Funnell and Wade (2012) who report the results of a longitudinal field study of a performance audit at the Australian National Audit Office (ANAO).

Given the institutional setting and the empirical literature on internal audit negotiation, it is reasonable to assume that internal auditors frequently negotiate to accomplish their mission. Without consensus with auditees, auditees are unlikely to follow internal auditors' recommendations, which increases the likelihood that valid audit findings will not result in changes within the organization. Only by overcoming disagreements with the audited entity can internal auditors add real value to the organization. Furthermore, the publication of internal audit reports with unresolved disagreements not only reflects poorly on the auditees, but also on the IAF. Negotiations could be a solution to prevent this. Without negotiations, it is highly likely that the most powerful party (i.e. the one with better connections to senior management or the board) will prevail, and this does not necessarily have to be the IAF.

In this study I pursue two general research goals, which are addressed and answered in the two main parts of this study (see sections 3 & 4). The first general research goal of this study is to develop an analytical framework for internal audit negotiations that explicitly considers process and contextual factors derived from the existing literature on internal audit and external audit negotiations as well as from the general negotiation literature. This analytical framework not only systematizes the literature on process and contextual factors in internal audit negotiations, but also serves as a theoretical foundation for the subsequent interview study. I base the development of this analytical framework on the "Three-Element Accounting Negotiation Process Model" by Gibbins et al. (2001) and adapt it accordingly to the context of internal auditing. In doing so, I identify a variety of factors at both the process level (negotiation issue, auditor-auditee process, and negotiation outcome) and the context level (external conditions and constraints, interpersonal context, and capabilities of the negotiating parties) that potentially influence internal audit negotiations. Using this analytical internal audit negotiation framework, I address my second research goal, which is to examine when and about what (RQ1), why (RQ2), and how (RQ3) internal auditors negotiate. To explore internal auditors' perspectives on negotiations in practice and to achieve my second research goal, I conduct 23 semi-structured interviews with internal auditors (14 in-house and 9 external service providers).

I use the analytic negotiation framework not only as a theoretical basis for developing the interview protocol, but also for the preliminary within-case analysis of the interview data. Inductive analysis methods further serve to highlight commonalities and differences among all interviews without disregarding the specifics of each case (Yin 2018, 196). The three research questions (RQ1-RQ3) guide the further coding of the interviews (Miles and Huberman 1994, 58). This process is largely inductive, as no expectations or codes can be formulated in advance about the situations in which internal auditors actually negotiate in practice and about what (RQ1), why internal auditors resort to negotiation and what their goals are in doing so (RQ2), and what strategies and tactics internal auditors use to achieve those goals (RQ3).

I find that internal auditors negotiate in practice when the auditees show resistance (RQ1), which manifests itself in various professional and non-professional arguments related to different audit types and issues. The types of professional arguments that auditees present to internal auditors also give internal auditors an indication of whether the objection is more directed at the findings, the proposed actions, or the audit itself. Particularly when the auditees' arguments are non-professional—often an indicator of heated discussions—it is difficult for the internal auditors to discern whether it is unwarranted resistance or an indication of deeper problems that need to be addressed.

With respect to RQ2, I find that respondents negotiate disagreements with auditees out of a functional interest, i.e., to achieve their own goals. The reason for this is that internal auditors do not have a more effective tool at their disposal to persuade auditees to change their behavior, as they do not have the authority to issue instructions. Therefore, internal auditors seem to rely heavily on the cooperation of auditees to initiate corrective actions. This is a significant difference from external auditing, as internal auditors are not only tasked with detecting irregularities, but also with initiating changes in the audited areas so that errors can be corrected, problems be solved, and added value can be created.

With respect to RQ3, I find that all respondents prepare for upcoming "discussions" strategically and use value-creating (e.g., cost-cutting, logrolling, and bridging) and value-claiming strategies (e.g., positional commitments and threats) to persuade auditees in negotiation interactions, although most internal auditors are not aware that resolving disagreements with auditees can be characterized as negotiation. To achieve integrative outcomes, respondents often promote an open exchange of information and mutual trust through focused preliminary discussions with auditees or their supervisors, as well as respectful and objective treatment of auditees (also referred to as procedural fairness). A very frequently mentioned integrative tactic is to adapt the wording of the internal audit report without abandoning the actual audit findings and required actions (i.e. cost cutting). This is achieved, for example, by providing additional reasons for negative audit findings in the internal audit report (e.g., staff overload) or by presenting positive findings as well, which may ultimately persuade the auditees to agree with the audit findings and/or the actions to be implemented. Despite the many descriptions of value-creating strategies, respondents also describe and use strategies aimed at claiming values, particularly through positional commitments and threats. These tactics rely on expertise and authority within or outside the IAF and are intended to underscore internal auditors' determination to stand firm or persuade auditees to relent.

The development of an analytical internal audit negotiation framework and insights from the field into when and about what, why, and how internal auditors negotiate constitute the main contribution of this study. In this way, this study sheds light on the black box of interactions between internal auditors and auditees and demonstrates that negotiations in internal auditing are quite common and differ from negotiations in external auditing. This may be relevant to the practice of internal auditing, as many internal auditors rarely interpret interactions with auditees as negotiations and are rarely trained in negotiations. Specific negotiation training could therefore potentially improve the effectiveness of an IAF and thus internal audit quality.

In terms of empirical research, the elements of the analytical negotiation framework contribute to internal audit research by highlighting future research needs, as each process and contextual element may have an impact on internal audit negotiations and is thus potentially open to investigation. For example, this study shows that internal auditors often use both integrative and distributive negotiation strategies. In this context, future research could explore whether this approach is always beneficial, whether only distributive approaches should be used in certain situations, or whether there are situations in which internal auditors should avoid negotiation altogether.

Moreover, this study focuses specifically on internal auditors' reasons for negotiating and the strategies and tactics they use to do so, while further studies could additionally focus on negotiation outcomes and how they are affected by different negotiation strategies and contextual factors. Further research is also needed on the auditees' side and how they prepare for these negotiations, what strategies and tactics they use, and whether they interpret the interactions with the internal auditors as negotiations at all.

Lastly, the findings on internal audit negotiations provide important insights into the concept of internal audit quality (see Trotman and Duncan 2018), as these negotiations can affect multiple quality components simultaneously: the *audit process* in which the negotiation interaction occurs, the *audit output* in the form of the agreed-upon audit report, including findings and recommendations, and the *audit outcome* in the form of value added to the organization.

2. Relevant literature on internal audit activity and general research goal

2.1. Internal audit activity and potential reasons for negotiations

Internal audit adds value to an organization when it protects and improves the effectiveness of risk management, control, and governance processes through its assurance and consulting activities (The Institute of Internal Auditors (IIA) 2017, Definition and Mission of Internal Audit). Despite this wide range of responsibilities, much of the empirical research on internal auditing has focused on its impact on financial reporting because external auditors' views on internal auditing have long dominated this research (Abbott et al. 2016; Bame-Aldred et al. 2013; Brown and Fanning 2019; Roussy and Perron 2018; Trotman and Duncan 2018). However, according to the annually conducted "Pulse survey" of North American internal auditors, financial reporting accounts for only 14% of the total internal audit plan on average, and becomes even less important when the distribution of audits is considered in relation to high-risk areas within the organization (The Institute of Internal Auditors (IIA) 2022, 16–17). Thus, the IAF's responsibilities appear to go far beyond simply assisting the external auditors. For example, it has already been shown that the IAF is an important component of a company's corporate governance system that frequently interacts with management (e.g. Gramling et al. 2004; Prawitt et al. 2009; Roussy 2015; Trotman and Duncan 2018), various stakeholders use the IAF on a regular basis (Bame-Aldred et al. 2013; Ege 2015; Trotman and Trotman 2015), and yet there is little research on how internal auditing influences corporate management (Brown and Fanning 2019; Fanning and Piercey 2014).

In order to fulfill its various tasks, the IAF primarily informs the relevant parties within the company about its auditing and consulting activities (The Institute of Internal Auditors (IIA) 2017, Performance Standard 2440), but is not authorized to issue instructions to auditees in order to initiate any changes. Without authority to issue instructions, the question remains as to how internal auditors proceed when the auditees take a different view from that of the internal auditors and how internal auditors deal with these differences. Calvin (2021) shows that the IAF's failure to communicate effectively and appease agitated parties can lead to pressure within the organization to change valid audit findings, thereby reducing internal audit quality.

Even the IIA's current International Professional Practices Framework (IPPF), a conceptual framework that summarizes authoritative guidance for internal auditors, does not include guidance on how to proceed in the event of a disagreement with the auditee. Only the IIA's former Practice Advisory 2410-1 no. 12 on "Communication Criteria" included a reference to what to do in the event of a disagreement with the auditee (The Institute of Internal Auditors (IIA) 2013).[4] The former Practice Advisory recommended that internal auditors disseminate an audit report that includes both, the auditors' and the auditees' views and the reasons for their disagreement. In summary, the Practice Advisory suggested reporting disagreements throughout the organization, but did not provide guidance on how to avoid or resolve them. In addition to this more confrontational option of disseminating these audit reports throughout the organization up to senior management or the board of directors and risking negative consequences (e.g., further deterioration of the relationship with the auditees, a modification of valid audit findings, or an impediment to ongoing and future audits), the IAF and the auditees also have the cooperative option of resolving their disagreements up front.

A constructive way to overcome disagreements is through negotiation, where both parties try to attain their own goals while relying on the other party to achieve those goals (Roloff et al. 2003, 803). In this paper, I adopt a broad "negotiation" definition from Murnigham and Bazerman (1990), which was also used by Gibbins et al. (2001) in the creation of their "Three-Element Accounting Negotiation Process Model". In this sense, negotiations are "any context in which two or more parties with differing preferences jointly make decisions that affect the welfare of both (all) parties" (Murnigham and Bazerman 1990, 642–643). To clarify the term

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[4] See footnote 3.

“jointly make decisions”, I draw on another definition that describes negotiation as “a communication-based activity through which parties attempt to create understandings, agreements, or contracts that define the nature of their future interdependence” (Roloff et al. 2003, 803).

2.2. Practice and empirical literature on internal audit negotiations

Over the years, the literature on internal audit practices has repeatedly reported on negotiations (e.g. Burke and Kovar 1999; Dittenhofer et al. 2010, 67–74; Jeffords et al. 1993; Johnson et al. 1998; Kelly 2017; Pastor 2007; Perrin 2006; Pickett and Pickett 2010, 376, 855, 942; Seago 2017). For example, Jeffords et al. (1993) describe that internal auditors will negotiate during an audit to obtain better cooperation and negotiate at the end of an audit to convince auditees of their findings and recommendations. “Even when internal auditors may be able to impose recommended changes on an auditee, a lack of negotiation skill can lead to resistance and resentment” (Jeffords et al. 1993, 41). This perspective highlights the importance of negotiation for internal auditors throughout the whole audit process. However, there is little empirical research on internal audit negotiations and on the practice of internal audit in general (Roussy and Perron 2018) and several recent calls for research on this topic illustrate this shortage (Brown and Fanning 2019; Roussy and Perron 2018; Trotman and Duncan 2018).

Among these exceptions are three experimental and two field studies. In their experiment Fanning and Piercey (2014) show that managers are more likely to agree with the viewpoint of internal auditors if they are both likable and present their arguments in a thematically organized manner. These effects apply even if the underlying information provides relatively little support for the internal auditors’ conclusion. In another experiment, Brown and Fanning (2019) show that managers are more willing to follow the advice of internal auditors when they offer professional favors (e.g., waiving a minor investigation or an immaterial finding) and take a participative approach to auditing. In contrast, these effects reverse when internal auditors offers professional favors but use a more traditional approach (“police officer” approach) to the internal audit role.

Burton et al. (2012) show experimentally that management can also be influenced in the context of consulting engagements. Even when management has initial preferences for how to address an operational issue, internal auditors' recommendations that are inconsistent with management's preferences often lead to a change in management's final decision (Burton et al. 2012). This effect is even more pronounced when in-house internal auditors supplement their preference-inconsistent recommendation with quantified information (as opposed to qualitative information).[5] In examining the impact of the IAF on internal controls through a single-case field study in a large financial institution, Christensen (2022) shows that interactions between internal auditors and auditees during the various stages of the management letter process range from information sharing, discussions, to negotiations. According to Christensen (2022), the IAF and the client primarily negotiate the draft audit memo, which contains the IAF's description of observations, its recommended actions and deadlines, and the prioritization of those observations. Even in the public sector, internal auditors negotiate audit findings and their relationship with the auditees, as shown by Funnell and Wade (2012) who report the results of a longitudinal field study of a performance audit at the Australian National Audit Office (ANAO).

2.3. General research goal

Overall, there are many practice articles and some preliminary empirical evidence on internal audit negotiations. From this literature, at least, it appears that internal auditors negotiate with auditees to reach consensus and that various strategies and tactics appear to have varying degrees of success in convincing the auditees of the IAF's perspective. Nevertheless, there is no clear understanding of how exactly internal audit negotiations take place and what process and contextual factors influence these negotiations. It is important to be aware of these factors before conducting an interview study on this topic in order to avoid omitting factors that are important to the content of the interview or giving them too little consideration in the interview

[5] This effect was observed only for in-house internal auditors, but not for outsourced internal auditors, for whom the effect remained unchanged (Burton et al. 2012).

process. Therefore, I pursue two general research goals, which are addressed and answered in the two main parts of this study (see sections 3 & 4).

The first general research goal of this study is to develop an analytical framework for internal audit negotiations that explicitly considers process and contextual factors derived from the existing literature on internal audit and external audit negotiations as well as from the general negotiation literature. This analytical framework not only systematizes the literature on process and contextual factors in internal audit negotiations, but also serves as a theoretical foundation for the subsequent interview study. I base the development of this analytical framework on the "Three-Element Accounting Negotiation Process Model" by Gibbins et al. (2001) and adapt it accordingly to the context of internal auditing based on the current literature. Based on this framework, I create an interview protocol that forms the basis for my subsequent interviews with internal auditors about internal audit negotiations. The interview study serves to address my second research goal, which is to show when and about what, why, and how internal auditors negotiate.

3. Development of an analytical negotiation framework for internal auditing

3.1. Overview of Gibbins et al.'s (2001) basic negotiation process model

In this section, I first describe the basic structure of the Gibbins et al. (2001) negotiation framework for external auditing and then adapt it accordingly to the context of internal auditing in the following section. In doing so, I draw on the sparse empirical literature on internal audit negotiations, the more general internal audit literature, the literature on external audit negotiations, and the general negotiation literature. This approach is used to account for the contextual nature of accounting research in general (Gibbins et al. 2005; Libby and Luft 1993) and accounting negotiation research in particular (e.g., Beattie et al. 2000, 2001, 2004; Gibbins et al. 2001; Salterio 2012).

The "Three-Element Accounting Negotiation Process Model" by Gibbins et al. (2001, 537) divides the negotiation process into three elements: the accounting issue, the auditor-client process, and the accounting outcome. The elements of this process become antecedents for the next interaction when negotiations occur more frequently rather than just once. Moreover, this negotiation process does not take place in a vacuum, but in a specific context that also influences the negotiation process and consists of three categories: external conditions and constraints, the interpersonal context, and the capabilities of the parties (Gibbins et al. 2001).

3.2. Elements of a negotiation process model adapted to internal auditing

The individual process and context elements of the analytical negotiation framework for internal auditing and their relationship to each other are shown in Figure 1. The following sections describe the individual components of this framework in more detail.

3.2.1. Negotiation issue

According to Gibbins et al. (2001) and Salterio (2012), the starting point of a negotiation in an external audit is an accounting issue triggered by the auditor, the auditee, or an external event (e.g., a new standard). In particular, accounting issues where GAAP guidance is ambiguous or does not exist are often subject to negotiation (Gibbins et al. 2001; Johnstone et al. 2002).[6] In the context of internal auditing, an accounting issue could also be the starting point for negotiations, but the IAF's responsibilities are far more diverse and, as described in section 2.1, are not limited to financial reporting. The IAF can perform financial audits, compliance audits, operational audits, and management audits, among others; it offers audits that take place at regular intervals or only occasionally, such as investigative audits of reported irregularities (Pickett and Pickett 2010, 335–336). Depending on the type of audit, the negotiation issues may therefore be quite different from those of an external audit. Nonetheless, it is equally compelling

[6] Some authors refer to accounting issues where the applicable accounting standards are clear and unambiguous as *objective* issues and those where there is no clear treatment as *subjective* issues (e.g., Wright and Wright 1997; Trotman et al. 2005; Hatfield et al. 2010).

that negotiation in internal auditing will be more common when there is only ambiguous or no guidance on the subject matter.

In addition, as with external audit negotiations (Gibbins et al. 2001; Perreault et al. 2017), internal audit negotiations may involve several issues at once or only one issue at a time. As described in section 2.2, negotiation issues may arise throughout the whole audit process (Jeffords et al. 1993), with an accumulation of negotiations suspected during the reconciliation phase of the draft audit communication, which includes the IAF's description of observations, its recommended actions and deadlines, and prioritization of those observations (Christensen 2022). Following the model of Gibbins et al. (2001) and further adapting it to internal auditing, the analysis of a negotiation issue may include understanding the impact of the identified issue on the organization's risk management, control, and governance processes; the materiality of the issue; how the issue arose; and whether the issue came as a surprise to those involved. Whether a negotiation issue comes as a surprise to either party may have implications for that party's negotiation preparation. A surprised party is likely to be in a weaker negotiation position than the party that has identified the problem and can prepare for a possible dispute (Gibbins et al. 2001).

3.2.2. Auditor-auditee process

When an issue arises, the auditor-auditee process begins with the parties exchanging information and using their respective negotiation strategies and tactics to reach agreement (Brown and Wright 2008). According to Gulliver's (1979) analytical negotiation model, these negotiation interactions consist of two sub-processes, a cyclical process and a developmental process. The cyclical process describes the repetitive interactions of the negotiating parties in which they, among other things, exchange information, learn more about the other party and its goals, and prepare themselves accordingly for further interactions, while the developmental process describes the progression of the negotiation process across the cyclical processes (Gulliver

1979, chapters 4 & 5). In this sense, the strategic preparations for these interactions, both before and during the negotiation, are also part of the auditor-auditee process.[7] For example, Trotman et al. (2005) show that external auditors who prepare by putting themselves in the auditees' position through role-playing achieve better results in negotiation (e.g., better financial reporting, greater satisfaction with the negotiation, and increased attractiveness for future business with the auditees). In a similar vein, Moeller (2015, 361-362) also describes a pre-negotiation phase in his comprehensive internal audit handbook, in which he lists activities that internal auditors should consider prior to negotiation (e.g., critical analysis of the facts, establishing rapport with the auditees, setting goals and expectations, developing a preliminary negotiation plan, etc.).

The analysis of the auditor-auditee process also includes its duration, the number and status of auditors, auditees, and third parties directly involved in the negotiation, both inside and outside the organization (Gibbins et al. 2001; McCracken et al. 2008). Negotiations can be conducted informally and/or in formal meetings (Beattie et al. 2004). In addition, the parties' initial perceptions of possible outcomes are another process factor, as these perceptions determine individual beliefs about a mutually feasible solution (Gibbins et al. 2001; Gibbins et al. 2005). This seems particularly important for internal auditors because without consensus with auditees, the internal auditors' recommendations are unlikely to be followed, increasing the likelihood that valid audit findings will go unaddressed. In addition, internal auditors often encounter auditees repeatedly during subsequent audits, and unresolved disagreements could carry over to those audits. These situations, which contain both cooperative and competitive elements, are referred to as mixed-motive situations in the general negotiation literature (Pruitt and Carnevale 1993, 18; Roloff et al. 2003, 804). Depending on how a negotiating party weights its own potential

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[7] Whether and how successfully this preparation is carried out depends on negotiation skills, which are part of the parties' capabilities and thus a contextual factor.

outcome relative to the other party's outcome (or relationship with the other party)[8], that party chooses a more cooperative or a more competitive negotiation strategy (e.g., Pruitt and Carnevale 1993, 104–105; Pruitt and Rubin 1986, 28–29).

For example, empirical research on internal audit negotiations has already shown that auditees are more likely to comply with internal auditors' demands in negotiations when auditors offer professional favors (e.g., waiving a minor investigation or an immaterial finding) while taking a participative audit approach (Brown and Fanning 2019) or are both likable and present their arguments thematically organized (Fanning and Piercey 2014). On the other hand, a more traditional approach to internal auditing ("police approach") could also be useful, especially if the guidance on the negotiation issue is clear. However, auditees confronted with internal auditors who follow the traditional approach seem more likely to question the auditors' motives, especially when the auditors offer a professional favor, such as waiving a minor investigation (Brown and Fanning 2019, 184–185). Overall, internal auditors are likely to take both cooperative and competitive actions, as mixed-motive situations require both (Roloff et al. 2003, 804; Savage et al. 1989). It should also be noted that any negotiation strategy, no matter how rational it appears to be, is developed and used by individuals who are constrained by their knowledge, perceptions, preferences, and beliefs (Gibbins et al. 2001; Thompson 1990), and are therefore also susceptible to judgment biases (Thompson 1990; Thompson and Hastie 1990).

3.2.3. Negotiation outcome

At the end of this negotiation process is the outcome of the negotiation. The outcome of a negotiation may correspond to the preferences of each party, only one party or none of the parties (Gibbins et al. 2001). Depending on the interaction process of the negotiating parties and their use of cooperative and competitive negotiation strategies, this process leads to a dis-

[8] The individual's concern for the other party's goals is sometimes referred to as concern for the relationship (Filley 1975, 49–50; Savage et al. 1989, 40).

tributive or integrative negotiation outcome (Gibbins et al. 2001). Distributive bargaining typically involves rigid actions, conflict escalation, and win-lose or lose-lose outcomes, while integrative bargaining is characterized by flexible actions and win-win outcomes in which both parties maximize their joint gains (Gibbins et al. 2001; Putnam 1990, 4). However, the dichotomous distinction between integrative and distributive outcomes often falls short, as no outcome is a pure joint-gain or a pure win-lose, especially in negotiations with multiple negotiation items (Putnam 1990). Therefore, it might be more appropriate to evaluate the outcomes according to their degree of integrativeness and distributiveness (Putnam 1990, 24).

An important outcome of internal audit negotiations is the internal audit report, which should include at least "… a description of the work performed, [as well as] the internal audit findings and recommendations" (Moeller 2015, 415). Moreover, these negotiation outcomes have both a short-term and a long-term effect. In the short term, the goal is for auditees to agree with the internal auditors' findings and recommendations, and in the long term, for auditees to implement those recommendations accordingly. Auditees who only appear to agree with the internal auditors but are not truly convinced by the auditors' arguments are likely to implement the changes proposed by the auditors only partially, not to the expected quality, or not at all (Jeffords et al. 1993). This may result in discussions in the follow-up phase of the audit, which may indicate an unresolved negotiation issue. In addition, relationship outcomes should also play an important role in internal audit negotiations, as internal auditors often meet with auditees again during subsequent audits. A damaged relationship with the auditee as a result of a negotiation may destroy the prospect of future integrative outcomes or joint decision making in general, as trust is one of the most important prerequisites for sharing information and thus for leveraging integrative potential (Bazerman and Moore 2009, 161; Mannix et al. 1995). In addition, the results of negotiations also influence other stakeholders (e.g., management, the audit committee, the external auditor) who have access to these results and draw their own conclusions from them, which in turn may have personal and professional consequences for internal auditors and auditees (adapted from Gibbins et al. 2001). This situation becomes even more complex when one considers that the various stakeholders evaluate the audit process and audit results in qualitatively different ways (Trotman and Duncan 2018).

3.2.4. Context of the process model

The negotiation process described above takes place in a specific context, which can be divided into external conditions and constraints, the interpersonal context, and the capabilities of the parties (Gibbins et al. 2001). The goal of the following presentation of contextual factors is not to provide an exhaustive list of all possible individual influencing elements, but rather to identify general areas that may have an impact on the negotiation process in internal auditing. Moreover, the external conditions and constraints, the interpersonal context, and the capabilities of the parties should not be understood as distinct classes, but rather as typologies that partially overlap the negotiation process and also influence one another (Gibbins et al. 2001).

The context factor **external conditions and constraints** mainly comprises elements that cannot be influenced by the negotiating parties themselves (Salterio 2012), or at least cannot be changed in the short to medium term. These elements include, for example, accounting and auditing standards, other internal and external regulations, owner and creditor considerations, other third parties that negotiating parties feel accountable to, time pressure, industry practices, and ethical considerations (Gibbins et al. 2001). In addition, the empirical literature on internal auditing has shown that internal audit performance and the assessment of that performance by other stakeholders can vary depending on the sourcing arrangements, such as in-house auditing, co-sourcing, or full internal audit outsourcing (e.g., Abbott et al. 2007; Abdolmohammadi 2013; Desai et al. 2011; Glover et al. 2008; Jiang et al. 2020; Prawitt et al. 2012). External factors continue to include whether internal audit is used as a management training ground (e.g., D'Onza and Sarens 2017; Hoos et al. 2018; Messier Jr. et al. 2011), "an organization's culture and attitude towards the IAF" (Trotman and Duncan 2018, 249), the sector in which internal audit operates (e.g., private vs. public or highly vs. lightly regulated, etc.) (e.g., Christensen 2022; Funnell and Wade 2012; Kidron et al. 2016; Neu et al. 2013), whether senior management or the audit committee has more influence over the IAF ("serving two masters" problem) (e.g., Abbott et al. 2010; Eulerich et al. 2017; Hoos et al. 2018), and, more generally, the "tone at the top" (e.g., Hoos et al. 2015; Soh and Martinov-Bennie 2011; Wang and Fargher 2015).

According to Salterio (2012), the **interpersonal context** consists primarily of elements that deal with the role of the main actors in the negotiation and their relationship to each other. Empirical research on internal audit negotiations has already shown that a good relationship with the auditee can improve internal auditors' negotiation outcomes, e.g., through the use of a participatory audit approach (Brown and Fanning 2019) or a likable demeanor and thematically structured presentation of arguments (Fanning and Piercey 2014). Comparing the internal and external audit context, Burt (2016) empirically shows that auditees are more willing to share information about internal control weaknesses with internal auditors than with external auditors, and explains this result by auditees' stronger identification with internal auditors than with external auditors. Internal auditors also seem to identify more strongly with their company, but unlike external auditors, this does not lead to a more lenient assessment of control deficiencies (Stefaniak et al. 2012). There is overlap here with the external context factor "sourcing arrangements", as it is generally assumed that an in-house IAF has closer contact with the company's employees than an out-/co-sourced IAF, suggesting that the relationship between internal auditors and auditees is also influenced by the sourcing arrangements (Cho et al. 2015; Glover et al. 2008). On the other hand, external auditors are more likely to rely on the work of out- and co-sourced internal auditors because they consider them to be more objective than in-house internal auditors (Desai et al. 2011; Glover et al. 2008). These perceived contradictions between in-house and outsourced IAFs are also reflected in the findings of Seymore and Robertson (2020). They show that internal auditors who apply a high level of procedural fairness (via a participatory audit approach) influence managers' willingness to share tacit knowledge and subsequent knowledge of a material control weakness, but the type of knowledge shared (tacit vs. subsequent knowledge) depends on the nature of the sourcing arrangement (in-house vs. outsourced). However, the interpersonal relationship between internal auditors and auditees is not only influenced by the nature of the sourcing arrangement, mutual liking, or the type of audit approach. More generally, the interpersonal context is also influenced by the (relative) power[9] that the respective parties have over each other and the trust they have in each other (Pruitt and Carnevale 1993, 130–135). Moreover, interactions are not limited to internal auditors and auditees, but include all parties actively involved in the ongoing audit and negotiation.[10] Following Gibbins et al. (2001) and McCracken et al. (2008), these can be internal parties such as other executives, the board of directors, or the audit committee, as well as external parties such as creditors, regulators, and shareholders, and for the internal audit context should still include the external auditor.

The third contextual factor consists of the **capabilities of the negotiating parties**. Gibbins et al. (2001) and Salterio (2012) define these capabilities for the external audit context as the accounting and negotiation expertise of the parties and the expertise that the parties can draw on within their organization. In internal auditing, it is probably better to refer to domain expertise rather than accounting expertise, because internal audits typically also cover areas other than accounting (see sections 2.1 & 3.2.1). In addition, unlike external auditors, the expertise that internal auditors can draw on is likely to be limited to their own department or team, since at least in-house IAFs are part of the audited organization. Outsourced IAFs and co-sourced IAFs are an exception here, as they can usually draw on expertise outside the audited organization, which is why outsourced internal auditors are assumed to have greater technical knowledge

9 "Power may be thought of as the control of resources that, if used, will affect another party's future welfare. Two kinds of resources may be involved: the power to reward and the power to punish. […] Relative power is the extent to which one party is more powerful than the other" (Pruitt and Carnevale 1993, 130).

10 Again, there is a lot of overlap with the external context factors, but the focus of the interpersonal context is more on the actual interactions between these parties and how they influence each other through those interactions.

while in-house auditors are assumed to have greater organizational knowledge (e.g., Burton et al. 2012; Seymore and Robertson 2020).

The empirical literature on internal auditing has shown that IAF capabilities are related to elements such as auditor education level (Lenz et al. 2014; Shu et al. 2011) and auditor competence (Abbott et al. 2016; Ege 2015; Pizzini et al. 2015), and that the chief audit executive (CAE) in particular has a strong influence on internal auditing and its quality (e.g., Hoos et al. 2015; Lobo et al. 2022). Thus, it is also the CAE and internal auditors in the upper ranks who are expected to have negotiating skills (Abdolmohammadi 2012). Despite the CAE's influence on internal auditing, it is ultimately the internal auditors in the field who implement a particular audit approach (cooperative or traditional), which in turn is also influenced by how the auditors perceive their role and how they deal with role conflicts (e.g., Ahmad and Taylor 2009; Lenz and Hahn 2015; Roussy 2013, 2015). Therefore, in addition to their technical competence and suitability for the audit task at hand (Sarens and Lamboglia 2014), the internal auditors' skills also include communication skills and an understanding of their own role, which may change from audit to audit and over time (e.g., Gramling et al. 2004; Lenz and Hahn 2015; van Peursem 2005).

All the individual process and context elements of the analytical negotiation framework for internal auditing and their relationship to each other have now been described. Figure 1 provides a graphical overview of these elements and illustrates the relationships between them.

<<< Insert Figure 1 around here >>>

4. Interviews on internal audit negotiations

4.1. Specific research questions

Given the importance that negotiation can have on the success of internal auditors' work, the different process and context factors that can influence the course of these negotiations and the fact that there has been almost no empirical research on this topic, the general research objective of this interview study is to shed light on when and about what, why, and how internal auditors negotiate.

To achieve this goal, the general research objective is divided into three more specific research questions that focus on the negotiation process. This is important to investigate because the context and activities of internal auditors differ significantly from those of external auditors, as discussed in section 3.2, and therefore the empirical results of external auditing cannot simply be applied to internal auditing. Moreover, while the few experimental studies on internal audit negotiation present participants with cases that are presumed to be negotiated, there is little empirical evidence on when and about what internal auditors actually negotiate in practice. Based on the trigger for internal audit negotiations, my first research question is therefore:

RQ1: In what situations and about what do internal auditors negotiate with auditees?

Second, internal auditors are not forced to negotiate with auditees, but do so voluntarily, if at all. If internal auditors decide to negotiate, they will likely have specific goals in mind with those negotiations. This leads to my second research question:

RQ2: What are the goals of internal auditors in disagreements with auditees, and why do they resort to negotiation to achieve those goals?

Third, the auditors' goals will only be achieved if the auditees are persuaded, or at least sufficiently influenced, by the auditors' viewpoint. Empirical literature on internal audit negotiations indicates that various negotiation strategies and tactics used by internal auditors are associated with varying degrees of success (Brown and Fanning 2019; Burton et al. 2012; Fanning and Piercey 2014). In addition, auditees will not just react passively to auditors' attempts to influence them, but will in turn actively try to convince internal auditors of their point of view. These mutual persuasion attempts ultimately constitute the interaction process of a negotiation. This leads to my third research question:

RQ3: How do internal auditors approach the negotiation process, i.e., what specific strategies and tactics do they use in these negotiations to achieve their goals?

4.2. Interview method

To explore internal auditors' perspectives on negotiations in practice and to answer the specific research questions, I use a semi-structured interview approach.[11] Following this approach, I begin the interview with open-ended questions that are meant to be answered freely, in detail, and with minimal interruptions. Based on the responses to these questions, I ask follow-up questions to better understand the internal auditors' experiences.

In order to find suitable candidates for the interviews, I used a snowball approach (Berg and Lune 2014, 52–53; Malsch and Salterio 2016; Matthews and Ross 2010, 166). At a workgroup meeting of the IIA Germany, I made contact with experienced internal auditors. In order to acquire more external providers of internal auditing services for an interview, I also resorted to "cold calling". All internal auditors came from a wide variety of industries, company sizes and types, and therefore provided a useful, broad base for examining the general phenomenon of negotiation in internal audit processes. Contact with these internal auditors provided further contacts for interviews, so that a total of 23 internal auditors (7 female and 16 male) were interviewed, of whom 14 were in-house internal auditors (=IA#*No.*) and nine were external providers of internal audit services (=EIA#*No.*).[12] By interviewing both in-house internal auditors and external providers of internal audit services, I am able to capture possible differences in the negotiation process between these two groups that might result from their different institutional embeddedness (see also section 3.2.4).[13] Table 1 provides an overview of the demographic data

[11] The semi-structured interview approach is often used in accounting and auditing research that relies on interviews (e.g., Aghazadeh et al. 2022; McCracken et al. (2008); Trotman and Trotman (2015); Couchoux and Malsch (2022); Dodgson et al. (2020).

[12] In the following, the abbreviations in parentheses serve to distinguish between the individual in-house internal auditors (=IA#No.) and the individual external providers of internal audit services (=EIA#No.).

[13] In the interviews, however, I find no systematic differences between the responses of the in-house internal auditors and those of the external providers of internal audit services.

of the interviewees. Interview data collection was terminated when no significant new insights could be gained from the interviews (e.g., Aghazadeh et al. 2021; Malsch and Salterio 2016; Power and Gendron 2015).

<<< Insert Table 1 around here>>>

I use a semi-structured interview approach, which is "[…] a particularly effective means of gathering data when the subject matter of the interview is complex, sensitive or not well understood" (Matthews and Ross 2010, 227). In line with this approach, the interview starts with open-ended questions, which are supplemented in a second part by follow-up questions that relate to the analytical negotiation framework described in section 3.2. In this sense, the interview protocol structure is similar to that of McCracken et al. (2008) in their study on auditor-client negotiations. The open-ended questions are designed to encourage respondents to talk as freely and in as much detail as possible about a particular negotiation case of their choice, without being interrupted by the interviewer. In preparation for this study, informal conversations with internal auditors revealed that almost all internal auditors were critical of the term "negotiation".[14] For this reason, interviewees were asked about disagreements between them and the auditees, and the term "negotiation" was not used until near the end of the interview (Table 2, Part E).[15] Table 2 provides a brief overview of the entire interview protocol and Table 2, Part B, contains the open-ended questions.

Based on the specific case described by each interviewee and the level of detail in the description, follow-up questions were asked that drew on the internal audit negotiation framework (see section 3.2) to further illuminate the process and contextual factors of this case (see Table 2, Part C). The follow-up questions served as a reminder of the various influencing factors I

[14] These informal conversations occurred before the interview protocol was established, and none of these internal auditors participated in the final interview study.

[15] This approach borrows from that of Gibbins et al. (2005), who surveyed CFOs about disagreements with external auditors and avoided the term "negotiation" because it was considered to have negative connotations among CFOs.

wanted to talk to respondents about, rather than a rigid questionnaire requiring systematic answers in a given order. Each interview ended with a structured set of concluding questions (see Table 2, Parts D and E),[16] including questions about whether aspects on this topic were still important but not adequately covered in the interview,[17] and whether respondents could connect me with other internal auditors I could contact for an interview. In addition to the author, the interview protocol was reviewed in advance by two experienced audit researchers before being pre-tested with an internal auditor. After the pre-test, only minor changes were made to the interview protocol.

<<< Insert Table 2 around here>>>

The 23 interviews were conducted face-to-face (15) and over the phone (8) between February and May 2019. All interviews were conducted by the author in German and lasted an average of 122 minutes.[18] In 22 of 23 interviews, the interviewees consented to an audio recording of the interview, resulting in almost 54 hours of audio recordings. After prior consent, one of the 23 interviewees asked that the recording device be turned off approximately 10 minutes after the interview began. In this case, the recording was stopped and detailed notes were taken during the interview. At the beginning of each interview, I briefly explained my broad research goal, why I was interested in the experiences of internal auditors, and how I planned to use the data. I then assured each respondent that their answers would remain anonymous, that no connection could be made to them or their company, and asked for consent to record the interview (see Table 2, Introduction). Initial questions were then asked about participants' demographics (see Table 1 and Table 2, Part A) to allow participants to become familiar with the interview and recording. Following the approaches of Aghazadeh et al. (2021), Trotman and Duncan

[16] If the interviewees still had time available, I asked them after they had answered the questions from Table 2, Part D, whether they could briefly describe a second case that went better or worse than the case just described. I then asked the questions from Table 2, Part B again.

[17] The interviewees mostly had no or only insignificant additions to make, but these did not lead to any changes in the interview protocol.

[18] All quotes I provide in this paper are therefore the English translations of statements made in German.

(2018), and Trotman and Trotman (2015), all of this was done to make interviewees feel at ease and thus encourage them to share their information as freely as possible.

The audio recordings were transcribed verbatim by the author and seven student assistants, and the transcripts were subsequently checked again by the author against the audio recordings of the interviews. All transcripts were then imported into MAXQDA (qualitative data analysis software) for coding and further analysis. Initial coding began with a predetermined rough coding scheme (Miles and Huberman 1994, 58) that was guided by the analytical negotiation framework for internal auditing (i.e. negotiation issue, auditor-auditee process, negotiation outcome, negotiation context). This preliminary within-case analysis helped cope with the large amount of data (Eisenhardt 1989; Miles and Huberman 1994, 55).

After gaining a more structured overview of the data in this way and rereading the transcripts, the goal of further coding was to let the data speak and inductively derive categories from the interviews (Kenno et al. 2017). The goal was to highlight commonalities and differences between all interviews, without disregarding the specifics of each case (Yin 2018, 196). I have therefore chosen a cross-case analysis which was guided by three key themes "… to look for within-group similarities [and] inter-group differences" (Eisenhardt 1989, 540). The three key themes represent the three research questions (RQ1-RQ3) that were used to further code the interviews (Miles and Huberman 1994, 58). This process was largely inductive, as no expectations or codes could be formulated in advance about the situations in which internal auditors actually negotiate and about what (RQ1), why internal auditors resort to negotiation and what their goals are in doing so (RQ2), and what strategies and tactics internal auditors use to achieve those goals (RQ3).

Therefore, I examined the interviews through the lens of these three key themes to generate codes that would allow me to answer the specific research questions without ignoring the unique characteristics of each case. I conducted this process separately for each of the three specific research questions. Although the identified codes were still strongly based on single case criteria at the beginning of each inductive process, these codes were further refined with each subsequent cycle of interview analysis as codes were added, merged, split, and recombined (Miles and Huberman 1994, 62). As an example of this process related to RQ1, after several iterations it became apparent that situations in which internal auditors negotiate are influenced less by the nature of the audit or the ambiguity of the guidance and much more by the auditees' reasons or arguments for disagreeing with the internal auditors. With respect to RQ2, this process revealed that internal auditors negotiate with auditees primarily out of functional interest, i.e., they expect to achieve better results than they would without negotiation. With respect to RQ3, it became clearer with each successive cycle of interview analysis that the many different tactics mentioned by interviewees resembled integrative and distributive negotiation strategies and also included strategic, preparatory activities for interactions. Through the iterative process of reading, coding and refining, which was supported by the graphical mapping of the codes using mind-mapping procedures, the final coding scheme emerged.

In the next section, I present the findings on internal auditor negotiations that emerged from my analyses.

4.3. Findings

4.3.1. Situations in which internal auditors negotiate (RQ 1)

RQ1 explores the specifics of situations that lead internal auditors to negotiate with auditees. Compared to external audit negotiations, which focus on single or multiple components of the financial statements, internal audit negotiations appear to be much broader in content and cover a variety of audit types. Table 3, Panels A and B, provide a brief overview of the cases described by each respondent (column 1), broken down by type of audit (column 2), recurrence of the audit engagement (column 3), sourcing arrangement (column 4), the audit issue discussed (column 5), and when the disagreement arose in the audit process (column 6). According to respondents' descriptions, negotiations may occur during holistic assessments of subsidiaries and affiliates, operational audits, audits of compliance with internal and external regulations, simple cash audits, and investigative audits of reported irregularities, among others. In addition, negotiations take place within the scope of both regular recurring plan audits and non-recurring audits, both by in-house internal auditors and by external providers of internal auditing services. Furthermore, these negotiations involve a wide range of audit issues, such as the functioning of the internal control system, the appropriateness of disclosures in the financial statements, the implementation of new and compliance with existing legislation and company policies, and the effectiveness of operational processes. These issues usually arise during fieldwork or during the closing meeting at the end of the audit.

<<< Insert Table 3 around here>>>

Compared to external audit, internal audit negotiations do not appear to be dependent on the type or ambiguity of guidance, as the reported cases include all types of situations where there is clear guidance, ambiguous guidance, or no guidance at all. However, further analysis of respondents' descriptions reveals a typology based not on the type of audit or the ambiguity of the guidance, but rather on the type of arguments auditees make as to why they disagree with the internal auditors' view.

According to the interviewees' case descriptions, the type of arguments used by the auditees to build resistance to the internal auditor can be divided into professional and non-professional arguments. Professional arguments by auditees include questioning the audit or performance criteria applied, asserting that the relevant audit and performance criteria are actually being met, that the auditees have a different view of their own or the IAF's responsibilities, that the auditees have different ideas about actions to address the audit findings, that implementation of the recommended actions does not justify the effort, and finally, that the risk resulting from the findings is negligible or acceptable.[19] Non-professional arguments are not further subdivided, but range from simple defensive reactions to questioning the competence of the IAF or individual auditors to emotional outbursts and personal insults. Non-professional arguments often accompany professional arguments, but do not themselves provide any substantive justifications for the auditee's opposition.

Frequently, interviewees reported several types of arguments made by auditees during an audit to challenge the internal auditors' view. Table 4 shows the distribution of the different types of arguments made by auditees (professional and non-professional arguments) that external providers of internal audit services (Panel A) and in-house internal auditors (Panel B) faced in their respective cases that led to negotiations.

<<< Insert Table 4 around here>>>

Table 4, Panels A and B, illustrate that in almost all cases, auditees either argue that they would comply with all relevant criteria despite the internal auditors' findings (column 3) or question the criteria the auditors use to assess audit findings (column 2), even when the criteria are based on explicit legal requirements. In these cases, auditees also often argue that the risk arising from the auditors' findings is negligible or that they are not even aware of any risk (column 7).

To present these arguments in context, examples from the interviews for all types of arguments are provided below. For example, in the case presented by IA#4, the auditee questioned the audit criteria, considered the risk resulting from the audit findings to be lower, and the effort required to implement the actions to be too high.

> [The auditee argued] that [the statutory requirement] was simply not relevant to them and excessive, and that they did not have the staff and did not see the need to implement it. ... And then, of course, the classic [argument of the auditee] that [this] had already been audited as part of the financial statement audit and had never been objected to and had always been in order … [and] that the risk associated with it is not that high. (IA#4)

[19] In some cases, the arguments of the auditees did not suggest low risk awareness, but no risk awareness at all. However, these cases ultimately represent only one extreme of the different risk assessment and were therefore also assigned to the risk assessment category.

In even harsher terms, IA#11 reports on an auditee that questioned the audit criteria, which were based on the company's internal regulations, but at the same time considered the criteria relevant to him/her to be met and denied any responsibility for the part that was not met.

> The definition was there, the task description was there, and all organizational instructions and descriptions were clear. However, [the auditee] refused to accept responsibility in this regard, so there was dissent, which also had an effect on the proper performance of certain control activities … [The auditee further argued] "That's not my responsibility" … "This is the responsibility of another department". And also all written evidence [which clearly showed that it was his responsibility after all] was ultimately dismissed as "That's what it says, but it's not to be understood that way." (IA#11)

EIA#6 reports a case where it was necessary to review the implementation of a new legal requirement that gave smaller companies some leeway in implementation. Resistance came from the executive board because they assumed that they were already complying with this requirement.

> There are subtleties [in this regulation] that large companies have to apply accordingly, but there are also gradations in this area ... which means that small companies do not have to do as much, but they have to do something ... [However,] the executive board felt that was not the case. ... [The executive board] wanted to argue that away, which ultimately came down to the principle of proportionality ... "We are a small company" and [applying this rule to that extent would be like] "cracking a nut with a sledgehammer" and so on and so forth. (EIA#6)

Another professional argument that respondents encountered in their audits concerned the proposed actions to remedy the audit findings. IA#9 reports precisely on such a case, in which only the necessary actions were negotiated.

> During the audit, it was found that a legal requirement was not properly complied with. There was agreement with the auditee on the facts [and findings]. But there was disagreement about what should be done [based on these audit findings]. And so we got into a conversation, a discussion, long before the report was submitted. (IA#9)

In almost all cases described by external providers of internal audit services and in very many cases by in-house internal auditors, non-professional arguments were raised by the auditee (Table 4, Panel A and B, column 8), often the hallmark of a heated discussion. The following example illustrates such a heated discussion, in which an auditee commented on a legal requirement to EIA#2:

> “What you’re looking at is just [a work hindrance for us]. [The legal requirement] is a job creation measure for people who have not really made it.” And that was an opinion for which [this person] received applause from colleagues and superiors. (EIA#2)

However, unprofessional arguments can also be more subtle than in the case just described. In a negotiation characterized primarily by unprofessional arguments, EIA#5 faced the challenge of finding the real substantive arguments behind the auditees’ resistance.

> [In hindsight], the main problem was … that auditees simply felt overwhelmed by the volume [of documentation requirements from the parent company]. That was ... interesting, because ... when we took on the mandate, we were already the fourth auditing firm [in four years with this client].... [At that point] we did not know ... what exactly the problem was. ... Are the audit findings wrong or what is ultimately the core problem? ... At some point, the managing director had only mentioned once that it was all an impertinence. (EIA#5)

Even if it sounds trivial at first, internal audit negotiations are only necessary if there is some form of resistance from the auditees.[20] However, a closer look at the various arguments put forward by the auditees can shed light on why there is resistance and what interests might be behind it. While professional arguments provide various substantive clues that the internal auditors can address, non-professional arguments may point to deeper problems in the audited area that internal auditors may need to address in a different way. In all of the cases described here, internal auditors chose to negotiate with auditees to resolve the issues, regardless of the type of arguments on which the resistance was based.

In the next section, I will examine the goals internal auditors try to achieve in these cases and why they resort to negotiation to achieve these goals.

4.3.2. Internal auditors’ goals and reasons for negotiation (RQ 2)

As explained in section 3.2.2, negotiations in the context of internal auditing can be described as mixed-motive situations that are characterized by both competitive and cooperative elements. Even though internal auditors and auditees each pursue their own substantive negotiation goals,

[20] This follows directly from the definition of negotiation, which presupposes different preferences of the parties involved (see Section 2.1.), which in turn are made clear by the resistance of the auditees.

these cannot be achieved without the cooperation of the other side due to their mutual dependency. Although both competitive and cooperative elements are present in this situation, it is questionable whether internal auditors pursue explicit relationship goals in addition to substantive goals in these negotiations. Looking at the interviewees' descriptions of their negotiation goals, one can see that internal auditors are focused on achieving substantive outcomes, despite the different motivations and arguments of the auditees (professional or non-professional). Ultimately, internal auditors can only add value to their organization and fulfill their mission (The Institute of Internal Auditors (IIA) 2017, Definition and Mission of Internal Audit) if they resolve the issues identified, and this is also reflected in their negotiation goals.

This view was expressed in the statements of many interviewees, as their negotiation goals were very much focused on identifying and implementing corrective actions, sometimes accompanied by the goal of changing the risk awareness of the auditees. EIA#2 and IA#5 illustrate this view as follows:

> My goal ... was [for the auditee] to say at the end, "Okay, I have now heard and understood where the deficits are. And I agree with the suggestions to address the deficits and yes, we have a problem and yes, we can work on it together now." ... That [requires] a certain risk awareness that is not present [there] at the moment. Risk awareness and risk culture are the two keywords above that, and making it clear to those involved what this is all about in the first place. (EIA#2)

> Because that is the crucial thing, something that we might [only] look at again in 2, 3, 4 or 5 years … that it is already correct this time. That is the most important thing for me ... So it is always easy to come up with findings, yes, but it is hard to come up with findings and convince the auditee to sufficiently implement the [necessary] corrective actions. (IA#5)

It is noticeable that the internal auditors' negotiation goals are very much focused on the recognition and implementation of corrective actions by the auditee, and less on the auditees' recognition of the audit findings (EIA#1: "The goal was to get the auditee to admit it and then move on"). This is noteworthy in that the audit findings themselves were challenged quite frequently (see Table 4, columns 2 and 3).

In two cases (EIA#3, IA#14), interviewees described negotiation goals that were neither related to the recognition of audit findings nor to the recognition or implementation of corrective actions. In these cases, the internal auditors' goals focused on removing audit impediments. Without the removal of these audit impediments, it would not have been possible to perform the audit properly.[21] In this context, IA#14 reports on a case in which a managing director considered the audit at a subsidiary to be completely unnecessary. In this case, the internal auditors felt much pressure to justify why they wanted to conduct an audit, but ultimately prevailed:

> We just had to take this step [to conduct the audit] to really get clarity on the topic because we talked to a lot of people and actually got a different statement and opinion from everyone. ... And as an internal auditor I see it as my duty to convince senior management [that we need to conduct an audit in such a case], even if they [senior management] may not see the reason for it. (IA#14)

Even though internal auditors' negotiation goals are focused on achieving substantive outcomes, the basic problem of the mixed-motive situation remains. Without obtaining the cooperation of auditees, auditees are likely to implement proposed actions only partially, not to the expected quality, or not at all. The dual concern model may provide a possible explanation for this supposed contradiction, since interest in the other party may arise because of a genuine intrinsic interest or because of a purely functional interest arising from strategic considerations (Pruitt and Carnevale 1993, 104–109; Pruitt and Rubin 1986, 28–29). Applied to internal auditing, this means that, for purely strategic reasons, internal auditors could also take into account the interests of the auditees if this enables them to achieve their own goals.[22]

From the interviews it became clear that internal auditors negotiate with auditees mainly out of this functional interest, i.e. they expect to (better) achieve their own goals in this way. This functional interest is mainly attributable to the fact that internal auditors cannot issue instruc-

[21] In these cases, resistance from auditees or senior management occurred just before or right at the beginning of the fieldwork phase.

[22] For a general description of these instrumental considerations, see Pruitt and Rubin (1986, 31) and Pruitt and Carnevale (1993, 109).

tions to auditees (see section 2.1). However, internal auditors could also conceivably disseminate an internal audit report that includes both the internal auditors' and the auditees' views and the reasons for their disagreement, following former Practice Advisory 2410-1 No. 12 (The Institute of Internal Auditors (IIA) 2013). In the interviews, all internal auditors were aware of this option, but considered it more of a last resort (IA#11: "… because I am reluctant to strike with this 'mace'"), as there are various negative consequences and uncertainties associated with this approach. In addition, respondents also described why they believe negotiation is a more useful means of resolving disagreements than escalating to the executive board. IA#10 illustrates two of these aspects by showing that even when the executive board receives the internal audit report (with the auditee's counterstatement) consensus often still needs to be reached.

> It must be clear that we [the IAF] have a different opinion [than the auditee], but there must also be a solution, because we do not just see each other at the next audit, but already at the follow-up. [Let's say] we do not agree. What do I do with the needed action I wrote down [in the audit report]? I cannot implement it in that case. So we have had that in the past. [The audited area] says, "Yeah, we did not agree. I did not do anything." And then we [the IAF] thought about how to present that in the report to the board. So that was an awkward situation. It was then resolved because the board supported [our view] as well. Because it was in their interest, but in the past we also had board members who said, "I am not interested. You have to come to an agreement. I cannot take that away from you, and I cannot decide that for you, because you are the experts. And if you cannot agree ... I can only keep butting your heads together, because nothing else will do." In this situation, I [as an internal auditor] can say that we disagree, but we still have to reach a consensus. (IA#10)

In this sense, negotiation is seen as a way to ensure that the actions recommended in the internal audit report are actually implemented, that the relationship with the auditees is not unnecessarily damaged, and that ultimately change can be initiated in the company. Moreover, as IA#10 noted, without negotiation, the IAF cannot even be sure that the executive board will decide in their favor in the event of a disagreement, if the executive board decides anything at all. Thus, the ability to submit an internal audit report along with the auditees' dissenting opinion also creates uncertainty for the IAF and is not the effective tool that the IIA may have envisioned, at least in the past. This view was expressed in several interviews, as several respondents (EIA#2, EIA#3, EIA#7, EIA#8, IA#2, IA#3, IA#8, IA#10, and IA #13) indicated that simply sending an internal audit report (with the auditees' counterstatement) to the executive board is rarely used, especially when it is clear that the executive board does not support the IAF's view or does not want to take a stand. IA#13 explains this as follows:

> I did not have the backing [of the board]. That would have been possible if the [board had been willing to enforce the actions we recommended]. Because we knew that without their signature, … without their backing .... it would not work. We [the IAF] are not empowered to give instructions. ... Only our [executive board] can give instructions. (IA#13)

Even if the internal auditors are able to enforce their point of view to the executive board, and thus can use an internal audit report with a dissenting opinion from the auditees, almost all respondents indicated that they would first speak directly to the auditees and try to convince them of their point of view. Another reason internal auditors discuss matters with auditees first is to avoid errors (including their own). This reduces the likelihood of erroneous audit reports being sent to the executive board:

> If we have a finding or consider facts to be questionable, we very quickly seek a discussion with the audited unit. … We can also be mistaken or have misunderstood something. We want to be able to rule out an error on our part as quickly as possible. (IA#9)

Many respondents have indirectly institutionalized negotiation in their own regulations by committing themselves to obtain auditees' approval for each internal audit report.[23] IA#3 summarizes this view and contrasts it with the police audit approach, from which many respondents explicitly distanced themselves:

> And as I said, that's also part of our audit strategy, that we make a conscious effort ... to obtain the agreement of the audited entities. ... In my experience, this has also proven successful so far. … I remember other forms of internal audit reporting where you would go in as a cop, write things down, announce everything in a monologue, and then report back to the management board, and that usually went relatively wrong. (IA#3)

In this context, it was also pointed out that attention must be paid to the reputation of the IAF and that, in the view of all interviewees, discussing disagreements with auditees is part of due process (IA#1: "Fairness dictates that we have a final discussion with the auditee. After all, we

[23] However, in this sense, agreement with the auditees is also given if both parties agree to disagree and the auditees sign the audit report with a counterstatement.

want to maintain a decent relationship"), which resembles the participative audit approach (Pickett and Pickett 2010, 371). From the respondents' point of view, negotiations and discussions with auditees are not only seen as a form of informal influence, but also as a prerequisite for offering further internal audit services. IA#9 states in this regard:

> We want to be respected and we are respected. We are also respected as a partner. That's very important, because we have another task, namely that we provide management consulting as needed, for example for the Board of Directors and the audited units ... and that only works, of course, if we have a good reputation [with the board of directors and the auditees] and if our judgment and opinion are also valued. (IA#9)

Overall, it can be seen that the most frequently mentioned negotiation goal of the respondents is that the auditees take appropriate action to address the audit findings. To achieve this goal, internal auditors rely on the cooperation of the auditees and thus on negotiations, since they cannot issue instructions to the auditees. This ultimately results in a functional interest of internal auditors in the auditees, as the majority of internal auditors indicated that they can (better) achieve their own substantive goals if they also attend to the interests and relationships with the auditees.

This reasoning may also explain why the audit style of all respondents is best described by the participatory audit approach rather than the police approach, since negotiations require some sort of participatory approach. Now that the goals and rationale for internal audit negotiations have been outlined, the next section will show how internal auditors approach these negotiations, i.e., what strategies and tactics they use in these negotiations to achieve their goals.

4.3.3. Negotiation strategies and tactics used by internal auditors (RQ 3)

During the interviews, all respondents reported using negotiation strategies and tactics (consciously or unconsciously), although many respondents were not aware that the process of resolving disagreements with auditees could be understood as negotiation.[24] Strategies and tactics were used to convince auditees of the internal auditors' view and, in particular, of the need for

[24] This question was asked only in the last part of each interview (see Table 2, Part E), after the interviewees' case descriptions were completed.

action. These strategies and tactics can be broadly divided into preparatory activities (see section 4.3.3.1) and interaction activities (see section 4.3.3.2), depending on when they are used. Following Lax and Sebenius (1986, chapter 5 & 6) and Bazerman and Moore (2009, 155–161), the interaction activities of internal auditors can be further divided into value-creating (see section 4.3.3.2.1) and value-claiming strategies (see section 4.3.3.2.2), which essentially correspond to integrative and distributive strategies.[25]

4.3.3.1. Preparatory activities

In the event that disagreements arise between the internal auditor and the auditee, many respondents prepare for the upcoming "discussions" (= negotiations) by planning how they will proceed, especially with regard to the closing meeting. Disagreements and initial negotiation interactions regularly occur during the fieldwork phase (see Table 3, column 6), but often culminate in the closing meeting, where critical issues of the audit are discussed at the latest.

Similar to the empirical findings on external auditors' preparation activities for financial statement negotiations (e.g. sequence of issues to be discussed (Perreault et al. 2017), or taking the auditees' perspective to better understand their viewpoints (Trotman et al. 2005)), internal auditors report similar approaches to preparing for upcoming negotiations. After a disagreement arises and before auditors enter into negotiations with auditees, almost all internal auditors indicated that they first re-examine the facts, the findings based on them, and the actions derived from them. To do this, interviewees question themselves, consult with colleagues, and again with auditees. With this purely audit-related preparation, respondents want to counteract the asymmetry of information between them and the auditees and also avoid unnecessary confrontations.

[25] According to Lax and Sebenius (1986, 33), both strategies (value-creating and value-claiming) appear in every negotiation and are mutually dependent. For the sake of clarity, however, they are presented in two separate sections in this paper.

> We must never make a mistake at this point, professionally. If we somehow say, "Here, this is wrong. You made a mistake." and we later find out they did not. That's it. This must not happen with internal auditing. (IA#13)

> We [the audit team] then go through the report together intensively, and I [as audit manager] check with the auditors [on site] whether what they have written down there is reliable on the basis of the working papers, so that we actually go into a closing meeting that should be watertight in terms of the findings and also in terms of the corresponding actions. (EIA#7)

In addition to this purely audit-related preparation, however, respondents also prepare specifically for negotiations.[26] For example, interviewees define not only negotiation goals (see section 4.3.2), but also negotiation limits for particularly critical issues that they will not exceed (Pruitt and Carnevale 1993, 50–54). In addition, internal auditors also set themselves sub-goals if it seems unlikely that the auditees can be convinced of all the required actions during an audit, or if it is not possible to implement the required actions within a reasonable timeframe. IA#2 reports a case where he/she pursued these sub-goals over several years, including in audit planning, to eventually reach the final overall goal that auditees implement all required actions:

> And every time I planned the audits for the next year, I thought, "What would be the next step we need [to achieve our final goal]?" And I then translated that into appropriate audit assignments (i.e., sub-goals). (IA#2)

Moreover, in determining negotiation goals and limits, respondents often prepare for possible counterarguments from the auditees, some of which are already familiar to them from the fieldwork phase. To this end, some respondents explicitly adopt the perspective of the auditees during both the fieldwork and the preparation for the closing meeting. This is sometimes even done in the form of a role-play in order to better understand the resistance of the other side and to be able to respond to it more appropriately:

> So the core problem or the core solution path is to put yourself in the other side's shoes as an internal auditor [and also ask yourself]: "How would I do all this myself?" (EIA#5)

> We then always talked about who talks to whom, and when. … We also practiced this beforehand ... sometimes we also did role-playing games. (IA#13)

[26] Many of the following preparatory actions mentioned by respondents are only feasible if internal auditors are aware of existing disagreements and are not surprised by them.

In contrast, other interviewees reported preparing only for the facts relevant to the audit without explicitly mentioning the auditees' perspective.

> I [department manager] have prepared myself. I spoke once again with the audit manager. We went through the audit documents and the legal basis again, and finally I critically questioned our reasoning once more. (IA#4)

In closing meetings, internal auditors often have the strategic advantage of being able to determine the order of items to be discussed.[27] This often involves determining when particularly critical issues should be addressed. However, no clear result can be derived from the responses. Although all interviewees were aware of the importance of critical issues, some discuss the critical issues at the very beginning of the closing meeting in order to be able to finalize the important issues, while others place the critical issues further back in order to discuss first the issues on which agreement can be reached quickly. Still other respondents always have the same fixed order of items to be discussed for each closing meeting, e.g., due to report format requirements.

In preparing for the closing meeting, one interviewee reported an integrative strategy of reciprocity that Sanchez et al. (2007) have already studied experimentally in the context of external auditing. In some cases, EIA#4 intentionally includes more findings in the closing meeting so that he/she can make concessions on less important findings to enforce the findings that are important to him/her.

> Sometimes I prefer to bring [less important] findings to the closing meeting as well, so that I can also yield on some findings. By doing this, I get agreement on ten findings, for example, rather than taking only ten to the meeting and only getting agreement on nine findings. (EIA#4)

[27] There are two main types of documents on the basis of which internal auditors hold the closing meeting. Either the closing meeting is held on the basis of a slide presentation containing only the most important points and afterwards the internal audit report is sent to the auditee for approval, or the closing meeting is held directly on the basis of the draft internal audit report. The advantage of the slide presentation is seen in the fact that one can concentrate on the most important points in the available time of a closing meeting without having to discuss every sentence of the audit report. The advantage of closing meetings based on the draft audit report is seen primarily in the fact that the audited entities know the exact wording of the internal audit report. Thus, if agreement is reached at the closing meeting, no further discussion of individual formulations is to be expected.

In the case of closing meetings in which more than one internal auditor participates, the distribution of roles between the internal auditors involved is also taken into account.

> Most of the time we have a kind of division of roles in these [closing meetings], which is sometimes chosen consciously and sometimes unconsciously. In our case, the on-site auditor leads the discussion, and I, as the audit manager, provide support [where needed]. That's the understanding of the role. As an audit manager, it is sometimes crucial ... to steer the conversation in the right direction. (IA#5)

Similar to external auditing, where the audit partner is seen primarily as the relationship manager (McCracken et al. 2008), the internal auditor feels responsible for bringing heated discussions, where emotions are running high, back to a factual level.

> And I myself only audited selected processes, [in this case] human resource processes. Of course, that was a tactical choice, part of my strategy, because emotions [boiled up] in the audit and we had to find out where the problem was. So I dealt more with the personal aspects and basically used the formal aspect as an opportunity to get into a conversation. … [As an internal auditor] you always have to [understand], "What's going on with the [auditee]?" I mean, if [the auditee] just [vehemently disagrees]: "We are rude and everything we say is not true," then the auditee has a reason. … And if we can figure out what the reason is, then that can take a lot of pressure [off the audit and discussions]. (EIA#5)

> How did we manage it? With a lot of patience ... and the effort to come to our own non-aggressive, friendly communication. (IA#13)

Ultimately, internal auditors are concerned with achieving their goals, i.e. getting the auditee to acknowledge the findings, agree to the actions, and implement them. To facilitate this, some respondents said it is also important to consider how auditees can agree to findings and actions without losing face.[28] IA#3 and IA#11 illustrate this as follows:

> [As an internal auditor] you can write [in the internal audit report rather harshly]: "No control existed." However, you can also write [more conciliatory]: "Controls were not documented." (IA#3)

> I was constantly seeking conversation with the audited division manager. Not only at the beginning [of the audit], as is normally the case … but also repeatedly during the audit to coordinate things with him/her and ultimately get him/her to see reason. My idea was that he/she does not come out of the situation with a loss of face, but that he/she has the chance to say: "Well, it went badly, we did not take care of it, but we will." (IA#11)

[28] For a detailed description of the concepts of *face* and *facework*, see Wilson (1992) and Goffman (1967).

Although most internal auditors were unaware that resolving disagreements with auditees could be characterized as negotiations, many respondents were preparing for the upcoming "discussions" in a variety of ways. While all respondents mentioned substantive, audit-related preparations, strategic preparations beyond that varied, in some cases considerably. On the one hand, this may be because each case described is unique and the people and situations involved cannot be easily compared. On the other hand, most respondents relied on their own practical experience for the aforementioned preparations, and only a few indicated that they had once received systematic training in negotiation or conflict management.[29] Future research could address the extent to which a more systematic approach to negotiation preparation increases the parties' willingness to reach agreement and whether the better-prepared party is also more likely to prevail.

4.3.3.2. Interaction activities

4.3.3.2.1. Value-creating strategies and tactics

4.3.3.2.1.1. Tactics to promote an open exchange of information and mutual trust

As already shown in section 4.3.2, internal audit negotiations appear to occur primarily because disagreements often cannot be resolved by other means, as neither the internal auditor nor the auditee has the authority to unilaterally impose action. Consequently, the internal auditor and the auditee are dependent on each other to achieve their respective goals. In these negotiations, each party often lacks information about the interests and positions of the other party. However, knowledge of the other party's preferences is often a necessary prerequisite for analyzing their compatibility with one's own preferences and developing possible win-win agreements on this basis. The negotiation literature therefore emphasizes the need for information sharing between parties to learn more about each other's preferences (Bazerman and Moore 2009, 161) and thus

[29] This question was asked only in the last part of each interview (see Table 2, Part E), after the interviewees' case descriptions were completed.

be more likely to reach integrative solutions, “provided that there is integrative potential and that the parties adopt ambitious, but at the same time realistic, goals” (Pruitt and Carnevale 1993, 36). An important prerequisite for the parties to exchange information about their preferences on various issues is the trust they have in each other (Bazerman and Moore 2009, 161).

The respondents also seemed to be aware of this, because in all the cases described they took measures to promote an open exchange of information and mutual trust. One approach used by all respondents was preliminary discussions with the auditees. These were scheduled either when disagreements arose or in advance when critical audit findings were identified that could have far-reaching implications for a particular auditee. Respondents provided several tactical reasons why they thought it would be useful to hold preliminary discussions with auditees. In cases where the impact on individual auditees was deemed particularly severe, informal meetings were used more frequently to facilitate joint problem-solving.

> I do it informally. So when something like this comes up, I either knock on the person’s door in the evening or stop by to see if the person is immediately available. If we formalize this, we build up a certain expectation on both sides and I think it is harder to find a solution [then]. I prefer to prepare the auditee [individually] step by step. (EIA#1)

Preliminary discussions with auditees may also be conducted formally, especially if the internal auditor wishes to secure the agreement already reached with the auditees on site or at least have written documentation of statements made by auditees. This is frequently considered necessary by interviewees because in many of the cases described, the supervisors of the auditees also attend the closing meeting, but often have had little or no involvement in the audit up to that point. As a result, internal auditors are usually not only outnumbered at the closing meeting, but must also discuss the matter with a variety of people who may have different preferences. Preliminary discussions are used to reach binding agreements with auditees on findings and actions in advance, thereby reducing internal auditors’ uncertainties at closing meetings. In this way, not only are auditees unlikely to change their minds at the closing meeting, but, in the best case, they can also act as allies of the internal auditors and convince their superiors of the solutions discussed in advance.

> Before we issue an audit report, it is important that we have clarified with the auditee what the core [of this report] is. So we do not just write a report and [surprise] the auditee with our findings, along the lines of: “We’ll discuss that anyway [in the closing meeting].” That usually creates dissatisfaction ... and then that does not lead to a relaxed discussion ... [But] if we build it from the bottom up and gain the acceptance [of the auditees on site], then it is much easier to convince [their superiors] because then they will be convinced by their own employees as well, not just us. (IA#10)

Sometimes the internal auditors for various reasons also inform the higher management levels up to the board of directors in advance. For example, this may be a prerequisite for sharing information at all, or it may prevent the board of directors or other superiors from being surprised by severe audit findings.

> At the management level, … there was initially great resistance [to our audit]. This went so far that [the employees of this company] trembled during interactions with us, sweated heavily and did not hand over any of the requested documents. But after [we talked to the general manager], it was made clear to [them] that the general manager wanted the matter to be worked through [and that they would not suffer any negative personal consequences as a result of their cooperation with internal audit]. [This was a necessary prerequisite] for my team to work with the operational staff on this issue. (EIA#3)

> So you have to prepare [the executive board] for that as well, and I talk about it a lot, just to give them a heads up … I do not talk ... about [imponderables], but if something comes up [in the audit] that is going to lead to either massive disagreement or serious findings or both, [then I report it in advance.] ... So better one more conversation than one too few. (IA#11)

Not only the preliminary discussions, but also the nature of the communication is considered by the internal auditors to be conducive to information sharing and trust building. The respondents explicitly mentioned a respectful, objective treatment of the auditees in this context. On the one hand, this can motivate auditees to work with the internal auditors to resolve issues:

> “Oh, you [are not doing this and that right], that is bullshit, you have to do it this way.” I would never engage in that kind of conversation. Instead, I work out the audit findings with the auditees. So that they themselves say, “Well, actually, it would be good if we did it this way, but [we] still need to overcome the following obstacles.” (IA#2)

On the other hand, similar to Seymore and Robertson’s (2020) findings on the effect of internal auditors’ use of procedural fairness, the open exchange of information and respectful, objective behavior during negotiations contribute to auditees sharing tacit knowledge with internal auditors:

> With this more collaborative approach [it often works] better. That is true for 99% of our projects. ... The auditees are then more open-minded. People then also tell us of their own accord about weaknesses that we might not otherwise have discovered during the audit. You just have to be careful not to abuse their trust and make them feel taken advantage of. Nevertheless, you have to communicate the facts clearly to the client. (EIA#1)

All of the above approaches are part of integrative negotiation strategies by enabling the exchange of information and mutual trust, and building on that, integrative agreements that can be reached through the use of various tactics. What integrative tactics internal auditors use and how they do so is presented in the next section.

4.3.3.2.1.2. Tactics for reaching integrative agreement

Many of the respondents' strategic negotiation approaches can be classified as integrative strategies that are already known in the general negotiation literature but have received little or no attention in the context of auditor-auditee negotiations.[30] These integrative strategies most closely resemble the strategies understood in the general negotiation literature as cost cutting, logrolling, bridging (Pruitt 1981, 142, 153-155), and specific application of the (re)framing concept (Putnam and Holmer 1992).

Cost cutting as an integrative strategy is successful when one party achieves its goals while minimizing the costs the other party incurs as a result of its concessions (Pruitt 1981, 142). Forms of cost cutting may be aimed at "reliev[ing] the other party's concern about future implications of an agreement [or] … protect[ing] the other party's public or self-image from harm" (Pruitt 1981, 142). Both are concerns that are very often raised (directly or indirectly) by auditees when negotiating with internal auditors. The advantage of the cost cutting strategy is that,

[30] One obvious reason for this could be that the numerous empirical findings on negotiations between auditors and auditees refer to the context of the external audit and internal auditors' strategies might not be applicable there. Internal auditors, for example, have much more freedom in formulating the internal audit report and can therefore apply strategies that are not available to external auditors, since the external auditors' audit opinion is largely standardized and does not allow as much leeway.

optimally, the party using it does not have to deviate from its goals or demands, but uses other means to get the other party to agree to it (Pruitt 1981, 153). Internal auditors apply this strategy, for example, by adjusting the wording of the internal audit report so that auditees can save face with their superiors and thereby agree to the findings and actions:

> It is … always about assigning blame. I mean ... we do not mention any names [in the internal audit report], but ultimately the search for the one to blame always remains open. And ... there is always the usual defensiveness of the audited person, who often asks: "Can't we present it in a different way?" Then I always say: "We can work on the phrasing." Yes, I did that with a finding in this case, but the finding itself remained the same. ... This is always my strategy for dealing with such non-factual arguments. ... Because, of course, the [auditees] know very well that the audit reports also go to the board of directors and ... that they [the board] can ultimately find out who actually did or did not do certain things. (EIA#9)

In addition, by adjusting the wording in the internal audit report, the internal auditors can also achieve that the auditees implement actions already during the audit if, in return, the internal auditors present the auditees in a better light. In rare cases, this may even lead to a less severe audit finding. Some interviewees also mention that it is helpful to present the causes of audit findings as well as positive findings in the audit report to improve cooperation with auditees. IA#4 used these strategies as follows:

> In the event of a catastrophic audit result, an attempt should be made to persuade the auditee to implement some actions while the audit is still in progress. Then you can write, "First measures were already taken during the audit." If it is at the tipping point, you can also acknowledge certain measures during the audit as mitigating the risk. That is possible, you can do that. Of course, only to a certain extent. And then you should also always try to end the executive summary [the summary for the board] with a positively worded sentence. And, of course, it is good if the summary states that initial measures were already taken during the audit. And it is also important to check if other areas of the audit were okay: "There were no findings in this or that area", even writing: "Okay, everything was fine in this other area". You should include that as well ... Of course, an internal audit report contains more negative things than positive things overall. (IA#4)

> That is why we like to state the cause [for the findings in the audit report]. And the causes are often: insufficient knowledge, overload, or projects taking place at the same time or projects working against each other … and not the intention of the auditees to commit errors. (IA#10)

Many respondents also mentioned that auditees fear the amount of work required to implement the actions and are therefore reluctant to do so in negotiations. A very common cost cutting strategy was to present the actions in the closing meeting as openly as possible so that the auditees themselves could have a say in what the implementation might look like, in addition to having a say in the timeframe for implementation,[31] thereby reducing their resistance:

> In addition, we chose a very long timeframe for when the findings are due [i.e., implementation of the action] ... And I think that was the key factor in reaching agreement. One was the very long timeframe [for implementing actions] and the other was that we said: "You have to do something, but which option you choose to get to due process is up to you. But the decision must be comprehensible and documented." (IA#12)

Similar to the cost cutting strategy, internal auditors also employ strategies based on the concept of (re)framing (e.g. Bazerman and Moore 2009, 169–171; Putnam and Holmer 1992). At best, this allows them to achieve their own goals without having to make concessions themselves, namely by influencing the auditees' view of the issue and its solution. "Each bargainer enters the negotiation with fields of vision or frames of reference that help him or her construct meaning or make sense of the situation … Although scholars differ in their exact definitions of *frame* and of *reframing*, both concepts refer to the way negotiators come to understand their situation" (Putnam and Holmer 1992, 128). Moreover, these frames are not stable, but change through the interactions of the parties and thus adapt to each other (Putnam and Holmer 1992, 139–141). IA#5 applied this concept as follows:

> Of course, you also try to sell them the benefit [of the action]. Often, this is … a legal regulation that you have to implement. Then you have to try to make it clear that there is also a benefit [for the auditee]. And you have to try to sell that benefit to the auditee. ... We told [the auditee], for example, that [by implementing the measure] he/she could handle certain aspects of the process in a much more hands-on way and [thus also provide more valuable information] to the executive board. (IA#5)

Few interviewees also mentioned a strategy that can be seen as a mixture of (re)framing and cost cutting. This strategy was used in cases where auditees were reluctant to implement certain regulations because it might put them at odds with other departments in the organization by imposing additional work on them. In these cases, respondents proactively offered to hold the IAF responsible for this implementation. In this way, the IAF was able to ensure that these

[31] Different time preferences of the negotiating parties may also allow for integrative solutions (Pruitt and Carnevale 1993, 39).

regulations were implemented after all, and the auditees were able to present themselves to the other departments as "victims" of the IAF and did not have to fear any negative consequences as the originators of these additional requirements. IA#2 describes this as follows:

> And they [the auditees] did not want to constantly incur the wrath of [the other departments]. And because they could always say, "Yes, I am [not thrilled about it either], but the IAF is making me do this. We have to revise it now. Otherwise, they will not accept it …!" Therefore, they simply blamed the IAF and were not the ones who initiated the action. (IA#2)

In the case of IA#10, the ability to hold the IAF accountable for implementation requirements in other departments even allowed for a bridging strategy "… that satisfie[d] both parties' most significant needs" (Pruitt 1981, 154). The solution was discovered after long discussions with the auditees, because it was possible to formulate the actions in such a way that the implementations in other departments also provided benefit for the audited department itself. Ultimately, this linkage created an opportunity for both auditees and internal auditors to achieve their goals.[32]

> We felt that as the discussion went on, the positions became clearer and clearer as to what improvement we would achieve for the company if we reformulated [the actions] a little bit. ... And that is not just a formal improvement ... something in the rules that you are happy with, but something that you also apply in the process itself, and that also makes it better in the end. That just came out of the conversation. … The auditee has used the [IAF] to [additionally communicate its own information claims to other departments, along the lines of:] "Unfortunately, we now have to make this mandatory [due to internal audit requirements]." As a result, the auditee can [now] better fulfill its role and responsibilities. (IA#10)

However, internal auditors not only apply integrative strategies in which they themselves never give in, but also make concessions. Logrolling, as an integrative strategy, is a way "to exchange concessions on different issues, with each party yielding on issues that are of low priority to itself and high priority to the other party" (Pruitt and Carnevale 1993, 36–37). Thus, a prerequisite for logrolling is that the negotiating parties have different preferences with respect to the

[32] Bridging differs from logrolling "in that logrolling involves a simple additive combination of demands previously endorsed by each party, whereas a solution by bridging entails some novel substantive element not previously under consideration" (Pruitt 1981, 155).

items to be negotiated (Pruitt 1981, 153). For example, in one case, EIA#6 adjusted the assessment of an issue in exchange for approval of the required action:

> The [board] just did not want it to be in a higher deficiency category. ... We finally met in the middle and said, "Okay, how can we fix this?" We ended up agreeing on a deadline by which it had to be implemented. That was fine with me, because [it was not a pressing issue]. It would have been worse if we had [found it later]. Then I would have actually acted differently. (EIA#6)

In summary, internal auditors often use not just one, but a combination of several integrative strategies. Many of these strategies are already known from the general negotiation literature, but have so far received little or no attention in the context of negotiations between auditors and clients. As mentioned at the beginning of section 4.3.3.2.1.1, leveraging an integrative potential also depends on "ambitious, but at the same time realistic, goals" (Pruitt and Carnevale 1993, 36) and a high resistance to yielding (Ben-Yoav and Pruitt 1984). Since none of the parties knows in advance whether there is potential for integration, integrative strategies are primarily aimed at exploiting this potential (Lax and Sebenius 1986, 245). In these cases, if one party relies solely on integrative strategies, but in fact there is no integrative potential at all—which no party can know in advance—then there is a risk that this party will be exploited (Lax and Sebenius 1986, 246). In addition, even when an integrative potential is discovered, it still needs to be shared (Lax and Sebenius 1986, 33), which also requires the use of distributive strategies to claim the value. This is also reflected in the descriptions of the interviewees, who always use a combination of value-creating and value-claiming strategies. In the next section, I will outline how the interviewees made use of value-claiming strategies in negotiations.

4.3.3.2.2. Value-claiming strategies and tactics

As shown in section 4.3.1, negotiations are triggered by auditees' professional and non-professional arguments, which the internal auditors try to counter with their arguments. Depending on the intensity and type of the other party's resistance, negotiators have incentives to use contentious tactics to appear firm to the other party (Pruitt 1981, 74–75), to save face, and thus to avoid being exploited by the other party (Wilson 1992, 178). Moreover, negotiators may also have an incentive to “attack their opponent’s face when they perceive that their opponent is attacking, is resisting a warranted persuasive appeal, ... or is failing … to bargain in good faith” (Wilson 1992, 179). On the other hand, contentious negotiation tactics are also used to reduce the other party’s resistance (Pruitt 1981, 76–77).

Although the IAF cannot issue instructions to auditees, internal auditors use a variety of value-claiming tactics not only to resist arguments and pressure from auditees, but also to put pressure on auditees to give in. These strategies and tactics described in the interviews essentially fall into two broad categories: Tactics that rely on expertise and authority internal to the IAF and tactics that rely on expertise and authority external to the IAF.

Value-claiming strategies that rely on the IAF’s internal expertise and authority are based primarily on two contentious tactics: positional commitments and threats. Positional commitments include “various statements or moves … to underscore a bargainer’s determination to hold firm” (Pruitt 1981, 75), while threats are used “to get the other [party] to concede” (Pruitt and Carnevale 1993, 30).

A representative example of a positional commitment is described by EIA#1, who was confronted with a managing director who would not admit that he/she had made a mistake, nor was he/she accustomed to being questioned:

> I think it was the first time that the managing director was approached by a persistent internal auditor who said: “I am not going to let up and we are going to discuss this no matter how long it takes.” I do not want to say that it was a little bit ramped up, but as an internal auditor, of course, you stay on it if you think you have something, and it also makes you suspicious when you then get a reaction like that. … The managing director thought he/she could somehow smooth it out or talk it away, but then realized he/she could not. (EIA#1)

In addition, EIA#1 emphasizes that building this kind of image can also facilitate future interactions and reduce resistance, but once the people involved change, the problems can start all over again:

> In the next audit, we did not have such a case … Once you instill that [tough image] in someone, it stays in the back of his/her mind … If there had been a new managing

> director [at the next audit], the same discussion could have taken place again. (EIA#1)

Positional commitments have particular impact when their credibility is emphasized (Pruitt and Carnevale 1993, 33). Respondents primarily used three types of arguments when attempting to provide additional support for the credibility of their own position to the auditees. First, internal auditors highlight risks that could jeopardize the company or parts of it if the findings are not remedied:

> As we got further and further ahead with our findings, we then also argued: "This is the effect now. If no one performs this task, then these situations happen and we can't even assess whether something happened [i.e., what risks the company is actually exposed to]." So we kept trying to describe this risk situation to raise awareness and really get the auditee to give in. [IA#10]

Second, internal auditors also refer to external and internal regulations that do not allow them to deviate from their position:

> The next thing is to point out that these are legal requirements and not inventions of the IAF. And here again, it is important to name the legal requirements and prove that they are relevant to the [company]. (IA#4)

Third, internal auditors point to specific audit observations that clearly support their position and refute the auditees' arguments. In the case of EIA#4, this was possible through extensive preparation for the closing meeting:

> I had prepared relatively representative examples from various business areas. In this way, I was able to refute all his/her objections. For example, if this particular manager said, "But here, the internal policy must be applied in such and such a way," I was able to show him/her with the next example that it does not work that way either. ... Therefore, I could not ... [come to his/her conclusion at all.] That made him/her wonder, so he/she said, "yeah well, but" and then he/she jumped to the next example, which again I was prepared for and could show him/her: "Right here, it doesn't work either." So I had actually anticipated his/her objections. I ... was actually able to show him/her a counterexample for each of his/her objections, so that in the end he/she [finally] gave in. (EIA#4)

In rare cases, these arguments are even extended to threats in order to convince the auditees of the seriousness of the findings and the need to relent. However, in cases where respondents do use threats, they are always based on legitimate reasons and are often used only indirectly, which Pruitt and Carnevale (1993, 31–32) suggest should mitigate the negative consequences for the threatener. EIA#2 used this tactic as follows:

> “You [the auditee] are responsible [and the legal requirements are clear]” ... And if there is [another] audit, these auditors will also ask: “Why didn’t you do anything about it?” Then you are not going to say: “We have way too much work to do or way too few people.” Moreover, I have tried to make them understand that there are also personal consequences waiting for them if they do not even start to get things in order together with me now. (EIA#2)

In addition to these argumentative tactics, internal auditors also use other tactics to counter resistance from auditees appropriately. For example, some internal auditors indicated that it is useful to have “equality of arms” in negotiations, i.e., if a division manager of the audited division participates in discussions or negotiations, the head of the internal audit department [CAE] should also participate in those discussions or negotiations to counteract pressure from that level of the hierarchy:

> I [IA#11] also had to protect my staff and just wanted to avoid situations where the division manager interferes with the fieldwork phase of the audit. We try to keep it on the same level as much as possible. Hierarchical thinking is a difficult thing, but sometimes it helps. And I [CAE] didn’t want my staff here to potentially be exposed to the pressure of this division manager during the audit. That is not conducive. (IA#11)

The last value-claiming tactic, where the IAF relies on its own internal expertise and authority, is to make the wording of the draft and final audit report as precise as possible. Even though in some cases respondents see leeway in the wording of the internal audit report and the actions to be implemented (see section 4.3.3.2.1), the wording and proposed actions in the draft and final audit report can be very specific (positional commitment). According to the interviewees, this should, on the one hand, help the auditees to get ideas on how problems can be fixed concretely, but, on the other hand, also ensure that the auditees do not propose vague alternative actions which, in the end, can only be verified hardly during a follow-up audit or cannot remedy the existing problems at all.

> So we try to make the proposals [of actions to be implemented] as concrete as possible so that they really support the auditee and, above all, so that they can be followed up. An audit without follow-up is a toothless tiger, and the more concretely it is formulated, of course, the better it can be verified later. (EIA#7)
>
> There are risks that are there anyway. They then have to be described, and therefore the action results from these descriptions. Theoretically, you do not have to write anything down, because for anyone who reads [the report] properly, it becomes clear: “This is my risk. I have to eliminate this risk.” In fact, all you should write down as

> an action is: "Eliminate the risk!" I think that would be much better in theory. However, the basic problem is that when I have such a non-specific measure, the auditee comes up with a solution and the internal auditor says, "No, that's not how I imagined it, and it's supposed to look like this." [And then the auditee would reply:] "Then write it down for me the way you envision it, otherwise I'll discuss it with you for three rounds until you're satisfied. I'm not in the mood for that either." (IA#10)

However, internal auditors rely not only on tactics based on their own expertise and authority, but also on tactics that rely on expertise and authority outside the IAF. Value-claiming strategies that rely on expertise and authority outside the IAF are searching for allies and including a counterstatement of the auditee in the internal audit report. Finding an ally helps negotiators to better address the other party's counterarguments and thus build countervailing power at the same time (Pruitt and Carnevale 1993, 31). Internal auditors look for allies both within (other departments, board of directors, general managers, etc.) and outside the audited organization (auditing firms, regulatory agencies, etc.):

> In this case, we [the IAF] had also used [an auditing firm] as a consultant. We called them several times and asked them for their opinion on how the Financial Reporting Standard is generally implemented in our industry. And they confirmed us [in our view], and of course we were able to bring that up to the auditees as another argument: "All companies in our industry do it differently than you do." And that helped a lot, of course. (IA#5)

In order to safeguard its decisions, the IAF also involves the executive board (or individual members) unofficially in individual cases, i.e. before the final audit report or executive summary has been completed and in some cases even before the closing meeting with the auditees:

> And in addition, I had also called in an executive director because it was an important issue. I also briefly explained both views verbally to the executive director, and he/she also said: "Yes, I consider the jointly found solution to be suitable", which is why he/she also supported it and immediately released the necessary funds for it. (IA#9)

> We have a variant where, if I as the CAE have done the quality assurance of the internal audit report, before it goes to the operational areas [for discussion], this report first goes "informally" to the executive board member responsible for that area. It is first discussed with him/her [before we discuss it with the audited department]. This way we can make sure that there are no strategic considerations that we have not thought of or that are currently being discussed. The executive board member responsible for this area therefore also knows which topics already exist in his or her area at the draft level, so to speak. (IA#3)

These statements illustrate that early involvement of the executive board not only has the advantage that the IAF can be assured of the executive board's support in the event of disagreements with auditees, but also that potential agreements with auditees do not conflict with other objectives of the executive board. Ultimately, this measure serves to reduce uncertainty on the part of the IAF.

As a last resort, the IAF still has the option to offer auditees to include their counterstatement in the internal audit report. Strictly speaking, in this case the negotiation has almost failed. However, this approach can also be interpreted as a final positional commitment,[33] as it clearly conveys to auditees that the IAF will stand firm and make no further concessions, i.e. that the IAF's negotiation limit has been reached. This view is supported by the fact that, in some cases, auditees accepted the internal auditors' findings and actions when they were eventually asked to prepare a counterstatement to the internal audit report. Although internal auditors are more or less free to decide when to exercise the option of having auditees write a counterstatement, this option is particularly promising when the executive board supports the internal auditors' position. This has already been made clear by the quote from IA#10 in section 4.3.2, which describes the IAF's uncertainty about how the executive board will decide in the event of a disagreement between the IAF and the auditees, if a decision is made at all. Moreover, asking the executive board to make a final decision may even weaken the IAF's position if the executive board rules in favor of the auditees or refers the decision back to the IAF and the auditees.[34] Therefore, the IAF's option to have the auditees write a counterstatement is classified, on the one hand, as a last resort and, on the other hand, as a tactic that relies on an authority outside the IAF, in this case the executive board.

[33] I explicitly categorize this action as a positional commitment rather than a threat, as respondents never portrayed this action as a threat in their case descriptions.

[34] In the second case, the IAF's position is weakened because the internal auditors cannot again request a counterstatement from the auditee, but must reach an agreement with the auditee.

In summary, internal auditors use value-claiming tactics that primarily consist of positional commitments and (indirect) threats. These tactics are either based on the IAF's internal expertise and authority or rely on expertise and authority outside the IAF and are intended to clearly advocate the IAF's position and put pressure on the auditee.

5. Discussion and conclusion

The objective of this study was to examine internal auditors' views on negotiation interactions with auditees during audit processes. For this purpose, I conducted 23 semi-structured interviews with internal auditors (14 in-house and 9 external service providers) from different industries, company sizes and types to gain insight into when and about what (RQ1), why (RQ2), and how (RQ3) they negotiate with auditees. Due to the scarcity of empirical evidence on negotiation in internal auditing, I first adapted Gibbins et al.'s (2001) negotiation framework to the internal auditing context based on the sparse empirical literature on internal audit negotiations, the more general internal audit literature, the literature on external audit negotiations, and the general negotiation literature. In doing so, I identified a variety of factors at both the process level (negotiation issue, auditor-auditee process, and negotiation outcome) and the context level (external conditions and constraints, interpersonal context, and capabilities of the negotiating parties) that (potentially) influence internal audit negotiations.

This negotiation framework also served as the theoretical basis for the development of the interview protocol and for the preliminary within-case analysis of the interview data. Inductive methods of analysis further helped to highlight commonalities and differences between all interviews, without disregarding the specifics of each case (Yin 2018, 196). This process was largely inductive, as no expectations or codes could be formulated in advance about the situations in which internal auditors actually negotiate and about what (RQ1), why internal auditors resort to negotiation and what their goals are in doing so (RQ2), and what strategies and tactics internal auditors use to achieve those goals (RQ3).

The results for RQ1 show that, in contrast to external audit negotiations, internal audit negotiations rarely occur during financial statement audits, but rather during other types of audits that cover a wide range of audit issues. In addition, internal auditors negotiated when the auditees showed resistance, which manifested itself in various professional and non-professional arguments (see Table 4). The types of professional arguments that auditees presented to internal auditors also gave them an indication of whether the objection was more directed at the findings, the proposed actions, or the audit itself. Particularly when the auditees' arguments were non-professional—often indicating heated discussions—it was difficult for internal auditors to discern whether it was unfounded resistance or an indication of deeper problems that needed to be addressed.

The results for RQ2 show the reasons why respondents chose to resolve disagreements with auditees through negotiation and the goals they sought to achieve by doing so. Respondents negotiated their disagreements with auditees out of a functional interest, i.e. they expected to (better) achieve their own goals in this way. The reason for this is that internal auditors do not have a more effective tool at their disposal to persuade auditees to change their behavior, as they do not have the authority to issue instructions. Therefore, internal auditors relied on the cooperation of auditees to initiate corrective actions "to add value and improve an organization's operations" and "to enhance and protect organizational value" (The Institute of Internal Auditors (IIA) 2017, Definition and Mission of Internal Audit). This is a significant difference from external auditing, as internal auditors are not only tasked with detecting irregularities, but also with initiating changes in the audited areas so that errors can be corrected, problems be solved, and added value can be created. This reasoning may also explain why the audit style of all respondents is best described by the participatory audit approach rather than the police approach, since negotiations require some sort of participatory approach to take place. This indirectly supports the experimental findings of Fanning and Piercey (2014) and Brown and Fanning (2019), who find the participatory audit style to be beneficial to internal auditors in negotiations.

The results for RQ3 show that all respondents (consciously or unconsciously) used negotiation strategies and tactics, although most internal auditors were not aware that resolving disagreements with auditees could be characterized as negotiation. In addition, all respondents were preparing for upcoming "discussions". While all respondents mentioned substantive, audit-related preparations, strategic preparations beyond that varied, in some cases considerably. Nonetheless, some respondents prepared for negotiations by, for example, anticipating possible arguments from the auditees through role-playing, becoming aware of their negotiation limits, and strategizing the order of points to be discussed in the closing meeting. Future research could address the extent to which a more systematic approach to negotiation preparation increases the parties' willingness to reach agreement, whether the better-prepared party is also more likely to prevail, and how this affects the quality of internal auditing.

In terms of negotiation strategies in actual interactions with auditees, all respondents used value-creating (e.g., cost-cutting, logrolling, and bridging) and value-claiming strategies (e.g., positional commitments and threats) to persuade auditees (RQ3). To achieve integrative outcomes, respondents often promoted an open exchange of information and mutual trust through focused preliminary discussions with auditees or their supervisors, as well as respectful and objective treatment of auditees (also referred to as procedural fairness). One of the most popular integrative tactics was to adapt wording in the audit report without abandoning the actual findings and required actions (cost cutting). This was achieved, for example, by providing additional reasons for a negative audit finding in the audit report or by also presenting positive findings. Another tactic was to adjust the timeframe for implementing corrective actions to address auditees' concerns about whether they could implement them with the given capacity.

In summary, internal auditors often used not just one, but a combination of several integrative strategies. Many of these strategies are already known from the general negotiation literature, but have so far received little or no attention in the context of negotiations between auditors and auditees. Further empirical research is needed in this area, for example, by examining the effectiveness of these value-creating strategies in an experimental setting.

Despite the many descriptions of value-creating strategies, respondents also described and used strategies aimed at claiming values, particularly through positional commitments and threats. These tactics relied on expertise and authority within or outside the IAF and were intended to underscore internal auditors' determination to stand firm or persuade auditees to relent.

This study is also subject to some limitations. The interviews were based on the interviewees' recollections of a recent negotiation case from their professional past. In some cases, this meant that the auditees had not yet signed the final internal audit report at the time of the interview or that follow-up audits on the findings were still pending. A uniform evaluation of the negotiation outcomes, which depend on final internal audit reports and follow-up audits, was therefore not possible, which is why they played only a minor role in this study.

Although all interviewees were able to describe instances of negotiation with auditees, these recollections may be biased, as can be the case with all interviews with individuals about their recollections (e.g., Pieters et al. 2006; Tversky and Marsh 2000). In addition, only one party, namely the internal auditors, made all statements regarding the negotiations. It is possible that auditees may view these negotiations differently than internal auditors, but this study cannot comment on that, only highlight the need for future research in this regard.

Originally, both in-house internal auditors and external providers of internal audit services were interviewed to uncover possible differences between these groups. The analysis did not reveal any systematic differences between these groups, but this does not mean that there could not be differences between them. It is possible that differences would have emerged if an even larger number of interviews or a different research approach (e.g., questionnaires) had been used. However, since internal auditors view the term “negotiation” critically, I deliberately decided against a questionnaire study, since it does not provide an opportunity to ask follow-up questions about the answers given.

This study could also have been influenced by potential self-selection biases of the interviewees. Self-selection biases could stem from the internal auditors who agreed to participate in the interviews, but also from the selection of the cases they presented. In this context, however, it should be emphasized that a large proportion of the internal auditors I approached for an interview also participated in the study (about 30-40%), which at least somewhat mitigates self-selection in this regard. In addition, the diversity of the described negotiation cases between internal auditors and auditees did not indicate a one-sided representation and thus a bias due to self-selection. For example, cases were described in which the internal auditors were able to prevail, as well as cases in which the negotiations ultimately failed or the auditees prevailed.

This interview study provides an initial, deeper understanding of how internal auditors view and behave in negotiations with auditees in the audit process. “As such, this study is primarily descriptive. While it was guided by the [self-developed analytical framework for internal audit negotiations which is based on current theory on internal and external audit negotiations], thus providing results informed by theory, it does not test theory” (Gibbins et al. 2007, 418).

Despite these limitations, this study contributes to current research in internal auditing and audit negotiation and identifies future research needs. The development of an analytical internal audit negotiation framework and insights from the field into when and about what, why, and how internal auditors negotiate represent the main contribution of this study. In this way, this study sheds light on the black box of interactions between internal auditors and auditees and confirms that negotiations are quite common in internal auditing and are different from negotiations in external auditing. This may be relevant to the practice of internal auditing, as many internal auditors rarely interpret interactions with auditees as negotiations and are rarely trained in negotiations. Specific negotiation training could therefore potentially improve the effectiveness of an IAF and thus internal audit quality.

In terms of empirical research, the elements of the analytical negotiation framework contribute to research on internal audit negotiations by highlighting future research needs, as each process and contextual element may have an impact on internal audit negotiations and is thus potentially open to investigation. For example, this study has shown that internal auditors often use both integrative and distributive negotiation strategies. In this context, future research could explore whether this approach is always beneficial, whether only distributive approaches should be used in certain situations, or whether there are situations in which internal auditors should avoid negotiation altogether.

A greater focus on contextual factors could also be used to examine whether increased reputation and trust in the IAF by the board of directors has an impact on the likelihood that internal auditors will negotiate or that they will include counterstatements from auditees in their audit reports. Counterstatements by the auditees in this case could, for example, be included more frequently if the IAF's reputation and standing with the board would lead it to believe that the board would be more likely to rule in favor of the IAF in the event of a disagreement. Should this be the case, it would also be interesting to investigate whether this would lead to better or worse quality in the audited areas than if negotiations, i.e. persuasion by the IAF, had taken place.

Moreover, this study focused specifically on internal auditors' reasons for negotiating and the strategies and tactics they used to do so, while further studies could additionally focus on negotiation outcomes and how they are affected by the various strategies and contextual factors.

Further research is also needed on the auditees' side and how they prepare for these negotiations, what strategies and tactics they use, and whether they interpret the interactions with the internal auditors as negotiations at all.

Lastly, the findings on internal audit negotiations provide important insights into the concept of internal audit quality (see Trotman and Duncan 2018), as these negotiations can affect multiple quality components simultaneously: the *audit process* in which the negotiation interaction occurs, the *audit output* in the form of the agreed-upon audit report, including findings and recommendations, and the *audit outcome* in the form of value added to the organization.

Overall, it can be concluded that empirical research on negotiation in internal auditing is still in its early stages. This study contributes to this body of knowledge and raises further open empirical questions that can inform future research on internal audit negotiations.

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Tables

Table 1: Demographic data of interviewees

In-house internal auditors (n = 14)		**n**	**External providers of internal audit services (n = 9)**		**n**
Position:	CAE	7	Position:*	CAE	3
	Department Manager	4		Audit Manager	9
	Audit Manager	3			
Professional qualifications:*	CIA	8	Professional qualifications:*	CIA	3
	CISA	3		CPA	1
	other	4		CFE	2
	none	3		other	3
				none	2
Years of experience in internal auditing:			Years of experience in internal auditing:		
	4-9 years	4		4-9 years	2
	10-15 years	4		10-15 years	3
	over 15 years	6		over 15 years	4
Primary industry:*					
	Financial Services	6			
	Public Administration	2			
	Real Estate	3			
	Automotive	1			
	Healthcare	1			
	Research Institute	1			

Notes. This table shows the interviewees' position within internal audit, their professional qualifications, years of internal audit experience, and the primary industry of the organization for which the in-house internal auditors work.

* There is not one industry that can be specified for external providers of internal audit services, as they work for different clients in different industries. The total number of qualifications for in-house internal auditors and external providers of internal audit services is greater than the number of the respective interviewees because some internal auditors hold multiple qualifications. Similarly, external providers of internal audit services sometimes hold the position of CAE or audit manager, depending on the audit engagement and the audited organization. Therefore, the total number of positions held by external providers of internal audit services is also greater than the number of interviewees.

Table 2: Overview of the interview protocol

Introduction

- Brief personal introduction and explanation of why I am conducting an interview study and what I plan to use the results for.
- Assure respondents that their answers will remain anonymous, that no connection to them or their company can be made, and ask for consent to record the interview.

Part A – Basic demographic questions

…

Part B – Open-ended questions

1. Please, take a moment and recall a (preferably current) case in which you and the auditee(s) had a different view of a potential audit finding or a recommendation based on it.
   Describe this situation to me as comprehensively as possible.
2. Further details on the negotiation issue (2.1), antecedents (2.2), and process and outcome (2.3).
   - 2.1 To be more specific, try to remember this situation and please describe exactly the issue at hand.
   - 2.2 Please, take some time and describe to me how the disagreement came about.
   - 2.3 Please describe to me how this disagreement was ultimately resolved (if at all).

Part C – Categories of follow-up questions based on the analytical negotiation framework for internal auditing…[*]

3. …about the negotiation issue	4. …about the process	5. ...about the outcome
6. ...about external restrictions	7. ...about the interpersonal context	8. …about the parties' capabilities

Part D – Closing questions on the negotiation case

a. Why did you choose this particular case?
b. How often does this type of disagreement occur?
c. What was unique about this case and what of it is more common (occurs more frequently in your day-to-day work)?
c. Do you remember this case positively or negatively? Why?
e. Now, reflecting back on everything from the perception of the disagreement to the resolution, would you describe the resolution process and outcome as successful or less successful?
   How do you determine that?
f. When did this case take place?
g. What other areas and topics are discussed in the audit process? Where do differences of opinion also occur?

Part E – Final questions to conclude the interview

…

Notes. All interviews were conducted in German. The excerpt from the interview protocol presented here is the English translation of the German version of the interview protocol.

[*] Each of the categories presented here in Part C contained several follow-up questions that could be asked during the interview but are not presented individually here.

Table 3: Descriptive characteristics of the cases described by internal auditors

Panel A – Cases described by external providers of internal audit services

Internal Auditor #	Type of audit engagement	Recurring audit engagement	Sourcing arrangement	Disputed audit issue(s)	Time of the emergence of the disagreement
EIA#1	**Holistic assessment** of a subsidiary/an affiliate company	recurring	Co-Sourcing	Appropriateness of an expense report	fieldwork phase
EIA#2	**Audit-related consulting** on the company-wide **corporate compliance system**	non-recurring	Co-Sourcing	Appropriateness of the corporate compliance system	fieldwork phase
EIA#3	**Holistic assessment** of a subsidiary/an affiliate company	recurring	full outsourcing	Valuation of an asset in the financial statement	fieldwork phase
EIA#4	**Operational audit** of business processes in a corporate division	recurring	full outsourcing	Appropriateness and functioning of the performance-based remuneration system	closing phase
EIA#5	**Holistic assessment** of a subsidiary/an affiliate company	recurring	full outsourcing	Appropriateness of the internal control system	fieldwork phase
EIA#6	**Audit of legal compliance** in a corporate division	recurring	full outsourcing	Implementation scope of new legal requirements	closing phase
EIA#7	**Holistic assessment** of a subsidiary/an affiliate company	recurring	Co-Sourcing	Requirements for the documentation of an internal control activity	closing phase
EIA#8	**Cash audit** in a corporate division	recurring	Co-Sourcing	Performance and documentation of internal control activities and the use of funds	fieldwork phase
EIA#9	**Holistic assessment** of a subsidiary/an affiliate company	recurring	Co-Sourcing	Access authorizations to an IT system	fieldwork phase

Panel B – Cases described by in-house internal auditors

Internal Auditor #	Type of audit engagement	Recurring audit engagement	Sourcing arrangement	Disputed audit issue	Time of the emergence of the disagreement
IA#1	**Audit of cash management** in a corporate division	recurring	in-house	Liquidity planning	fieldwork phase
IA#2	**Operational audit** of business processes in a corporate division	recurring	in-house	Vulnerability of the business model to macroeconomic changes	closing phase

Table 3, Panel B continued…

Internal Auditor #	Type of audit engagement	Recurring audit engagement	Sourcing arrangement	Disputed audit issue	Time of the emergence of the disagreement
IA#3	**Cash audit** in a corporate division	recurring	in-house	Responsibility for and performance of internal control activities	closing phase
IA#4	**Audit of legal compliance** in a corporate division	recurring	in-house	Implementation scope of new legal requirements	closing phase
IA#5	**Audit of legal compliance** in a corporate division	recurring	in-house	Implementation scope of new legal requirements	fieldwork phase
IA#6	**Audit of the effectiveness of the internal control system** in a corporate division	recurring	in-house	Appropriateness of an internal control activity	closing phase
IA#7	**Audit of the effectiveness of the internal control system** in a branch office	recurring	in-house	Monitoring and execution of internal control activities	fieldwork phase
IA#8	**Audit of compliance with corporate guidelines** in a subsidiary	recurring	in-house	Appropriateness of contracting for services	fieldwork phase
IA#9	**Audit of legal compliance** in a corporate division	recurring	in-house	Way of implementing the legal requirements	fieldwork phase
IA#10	**Audit of the effectiveness of the** company-wide **internal control system**	recurring	in-house	Extent of internal control requirements imposed by the second line of defense on the first line of defense	fieldwork phase
IA#11	**Investigative audit of the functionality** of a corporate division	non-recurring	in-house	Execution of the assigned tasks, in particular performance of internal controls	fieldwork phase
IA#12	**Operational audit** of business processes in a corporate division	recurring	in-house	Completion of assigned tasks and duties	fieldwork phase
IA#13	**Investigative audit of legal compliance** in a corporate division	non-recurring	in-house	Appropriateness of contracting for services	fieldwork phase
IA#14	**Investigative audit of legal compliance** in a branch office	non-recurring	in-house	Necessity of an investigative audit	planning phase of the audit engagement

Notes. This table provides a descriptive overview of each case that respondents talked about. The second column shows the type of audit engagement that respondents talked about. Bold in the column are the types of audits, not bold are the parts of the corporation, to which the audit referred to. The third column indicates whether an audit was performed more than once or only once. The fourth column shows the type of sourcing arrangements within which the auditors were engaged. Column five contains a brief description of the audit issue on which the auditor and the auditee disagreed. Column six indicates when the disagreement of the issue described in column five arose in the audit process. For clarity, only three phases are distinguished here, the planning phase, the fieldwork phase, and the closing phase. The planning phase includes everything up to and including the kick-off meeting with the auditee. The fieldwork phase includes all audit activities before a closing meeting has taken place. The closing phase includes everything from the closing meeting to the preparation and mailing of the final internal audit report.

Table 4: Type(s) of arguments used by auditees to disagree with internal auditors

Panel A – Auditees' arguments described by external providers of internal audit services

	Auditees' professional arguments						**Auditees' non-professional arguments**
Internal Auditor #	**Audit/Performance criteria are being questioned**	**(Relevant) criteria are considered to be met**	**Different delimitation and perception of responsibilities**	**Different ideas for actions to address audit findings**	**Effort for implementation of actions too high**	**Risk evaluated differently**	
EIA#1	X	X				X	X
EIA#2	X	X			X	X	X
EIA#3		X		X			X
EIA#4						X	X
EIA#5	X			X	X	X	X
EIA#6		X			X	X	X
EIA#7		X			X	X	
EIA#8	X	X	X	X		X	X
EIA#9					X	X	X

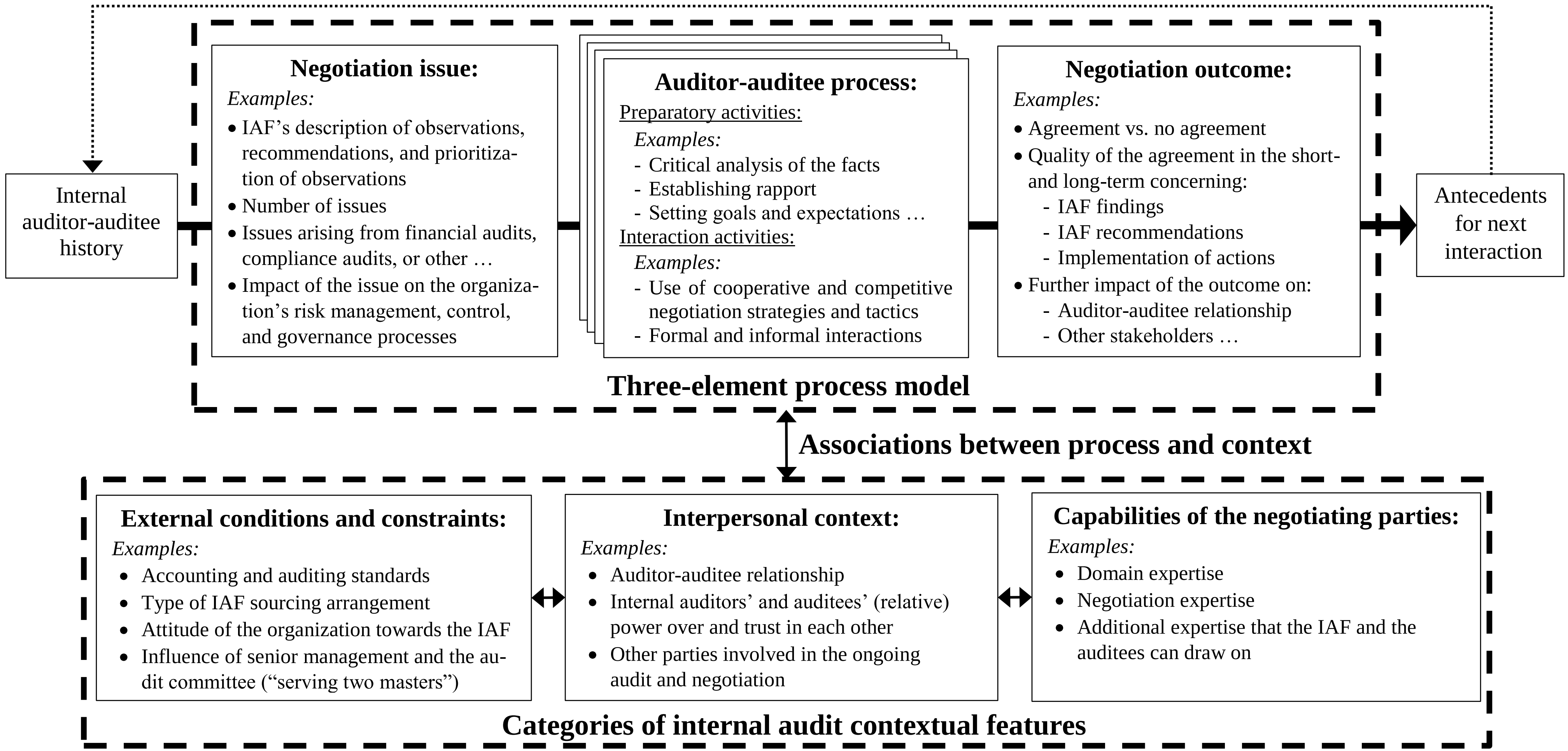
Panel B – Auditees' arguments described by in-house internal auditors

	Auditees' professional arguments						**Auditees' non-professional arguments**
Internal Auditor #	**Audit/Performance criteria are being questioned**	**(Relevant) criteria are considered to be met**	**Different delimitation and perception of responsibilities**	**Different ideas for actions to address audit findings**	**Effort for implementation of actions too high**	**Risk evaluated differently**	
IA#1			*unassignable*				
IA#2			X	X	X	X	X
IA#3	X		X			X	
IA#4	X				X	X	X
IA#5		X			X		
IA#6		X				X	
IA#7		X				X	X
IA#8		X	X			X	X
IA#9				X			
IA#10		X			X		X
IA#11	X	X	X				X
IA#12			X		X		X
IA#13		X	X			X	X
IA#14		X				X	X

Notes. This table shows the different types of auditee arguments (professional and non-professional) reported by each external provider of internal audit services (Panel A) and each in-house internal auditor (Panel B) that led to negotiations. Each "X" in a row means that the respective internal auditor mentioned the corresponding argument of an auditee (see column headings) at least once in the course of his/her case description, otherwise the cell remains empty. The reasons described by IA#1 for the disagreement with the auditees cannot be assigned to the above categories, as the auditees in the case described were not capable of being audited. The internal auditors ultimately had to terminate the audit because important documents were not provided by the auditees, were not provided in full, or were provided too late. Whether this is an intentional or unintentional action on the part of the auditee cannot be judged from the interview.

Figures

Figure 1: Analytical negotiation framework for internal auditing



Notes. This figure is based on the "Three-Element Accounting Negotiation Process Model" by Gibbins et al. (2001, 537) and has been adapted to the internal auditing context based on the descriptions in section 3.2. The upper box with the dashed lines represents the three-element process model, the lower box with the dashed lines the context features. The elements within these boxes as well as between the boxes influence each other, which is illustrated by the corresponding arrows. The individual process and context elements contain examples of internal audit negotiations, which are described in more detail in section 3.2. The overlapping boxes of the auditor-auditee process illustrate the cyclical and developmental nature of this process element (see section 3.2.2) and reflect the fact that a negotiation often consists of several rounds of interaction before a negotiated outcome is reached, if at all.

THE INFLUENCE OF TAX AUDITORS' EMOTIONS ON TAX AUDIT NEGOTIATIONS AND TAX COMPLIANCE

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Abstract

We study the effects of tax auditors' emotion expressions during tax audit negotiations. A first experiment shows that auditors expressing anger obtain more concessions from taxpayers than auditors expressing happiness. Thus, taxpayers interpret auditors' emotions strategically and do not respond affectively. A second experiment shows that the experience with an auditor who expressed either happiness or anger reduces taxpayers' post-audit compliance compared to the experience with an emotionally neutral auditor. Apparently, taxpayers use their experience with an emotional auditor to rationalize subsequent non-compliance. Overall, our findings demonstrate potentially detrimental effects of auditors' positive and negative emotion expressions and point to the benefits of avoiding emotion expressions: avoiding them does not result in fewer concessions from taxpayers than expressing anger, leads to a better evaluation of the relationship, and reduces taxpayers' post-audit non-compliance.

Keywords: Emotions; Negotiation; Audit; Tax Planning; Tax Compliance; Tax Evasion

JEL: M41 · M42 · H25 · H26 · D91

1. Introduction

Tax audits play an important role in detecting and deterring non-compliance with tax rules. However, due to considerable tax law ambiguity the outcome of a tax audit is often negotiated between the tax auditor and a representative of the audited entity (henceforth termed "tax-payer"). Given that the outcome of a tax audit negotiation may have immediate and severe financial consequences (in the form of back tax payments) for the taxpayer, while at the same time the generation of back tax payments is a crucial success factor in the evaluation of the auditor's work (Alissa et al. 2014), tax audit negotiations are likely to elicit a relatively high level of emotional involvement of the participating parties. When emotions of one party become perceivable for the other party during the negotiation, e.g., via verbal remarks or non-verbal mimics and gestures, they may influence the negotiation process and ultimately its outcome. Thereby, it does not matter whether these emotions emerge subconsciously or are being used strategically (Barry 1999; Kopelman et al. 2006). Moreover, prior research suggests that emotional experiences in negotiations may have longer-term consequences beyond negotiated outcomes (Wang et al. 2012). Thus, the emotional experience during a tax audit may also affect subsequent tax planning behavior.

We report the results of two experimental studies that examine the effect of tax auditors' emotions during a tax audit negotiation on (i) taxpayers' concession making during tax audit negotiations and (ii) post-audit compliance of taxpayers. We focus on happiness and anger as two discrete, basic emotions. The theory of basic emotions postulates that these emotions are distinct from each other, fulfill an evolutionary role by helping us deal with fundamental life-tasks (Ekman 1972, 1992a, 1992b), and that other non-basic emotions can be described as mixtures of the basic emotions (Ekman 1992a). Moreover, anger and happiness may likely occur in tax audit negotiations. For instance, during the negotiation process, tax auditors may openly display anger about the proceedings or behave friendly to ease a tense situation.

From a purely rational point of view, emotional cues from a tax auditor should neither influence taxpayers' concessions nor taxpayers' post-audit behavior because such cues do not alter the existing bargaining range or the underlying substantive conditions. However, on the one hand, the auditor's emotions may spill over to taxpayers and might thus cause *affective* taxpayer responses as predicted by social contagion theory (Levy and Nail 1993). As positive own emotions have been shown to increase the willingness to make concessions (e.g., Baron 1990), taxpayers facing a happy (angry) auditor may make more (less) concessions. In this vein, Perreault and Kida (2011) find that clients who negotiate with an auditor who expresses positive emotions offer greater concessions. In addition, post-audit tax compliance may also be affected by induced taxpayer emotions. People usually behave in such a way that they avoid (seek) negative (positive) emotions (Moreno et al. 2002). Because positive (negative) taxpayer emotions may compensate (amplify) negative feelings linked with non-compliance such as guilt and shame, positive (negative) emotions may decrease (increase) post-audit tax compliance (Fochmann et al. 2023).

On the other hand, the *Emotion As Social Information* (EASI) model (Van Kleef 2009) considers that the tax auditor's emotions may not only cause *affective* responses but could also cause *inferential* processes. In particular, the auditor's emotions may be considered as signals that reveal information about the tax auditor's point of view on the negotiation proceedings until then. Expressions of happiness may inform taxpayers that they can push the tax auditor even further in the favored direction so that they should make fewer concessions, whereas expressions of anger may signal to taxpayers that they should concede more to avoid a breakdown of the negotiation and therefore tedious and costly tax court disputes. Thus, in contrast to social contagion theory, one would expect that taxpayers who face a happy (angry) auditor make less (more) concessions. Moreover, if taxpayers interpret the auditor's emotion expressions as informative signals about the government's tax enforcement policy, the expression of happiness may signal that tax non-compliance is not a severe problem for the government and that the government does not exert rigorous coercive power, whereas the expression of anger may signal that the government takes an extremely strict stance, possibly even tending to exploit its citizens and to abuse its power. In both cases, the emotional signals could serve as a rationalization strategy to justify an increasing tax planning aggressiveness, so that individuals are able to maintain a positive self-view in terms of being a moral person despite engaging in actually immoral behavior (Mazar et al. 2008). This suggests that auditor expressions of both anger and happiness may decrease taxpayers' post-audit tax compliance.

Whether affective responses or inferential processes dominate in a tax audit setting is ultimately an empirical question. According to the EASI model, this depends mainly on the epistemic motivation, i.e., the information processing motivation of the negotiators: with high (low) information processing motivation, inferential processes (affective responses) dominate (Van Kleef 2014). Because a tax audit is a personally involving task with direct monetary consequences and because taxpayers are held accountable for their tax decisions, we expect a high information processing motivation. Thus, we predict that taxpayers are highly likely to interpret a tax auditor's emotional expressions strategically and not to react affectively to them.

To test our predictions, we conduct two experimental studies. The first experiment examines the influence of tax auditors' emotions on taxpayers' concession making in a tax audit negotiation. 86 business administration students participated in a computer-based, incentivized economic experiment. Participants had to negotiate the amount of five warranty provisions with a simulated tax auditor. While the negotiation algorithm of the auditor is the same in all treatments, we manipulate the emotional statements of the auditor. Using a 3x1 between-subjects design, we differentiate between the expression of happiness, anger, and the absence of emotional statements (neutral treatment).

The results are in contrast to the social contagion model but confirm the prediction that taxpayers interpret tax auditors' emotional expressions strategically, which is in line with the EASI model. On average, participants who negotiated with an angry tax auditor conceded 13.1% more than participants who negotiated with a happy tax auditor did. Notably, however, participants who negotiated with an angry tax auditor did not concede significantly more than participants who negotiated with an emotionally neutral tax auditor.

The second experiment examines the effect of tax auditors' emotions during a tax audit negotiation on taxpayers' subsequent tax compliance after the audit. 80 business administration students participated in the computer-based, incentivized economic experiment. After having completed the same negotiation as in the first experiment (i.e., either with an angry, happy, or neutral tax auditor), participants complete three tax compliance tasks relating to the tax returns of the following year where they have to decide on how much tax-deductible operating expenses they want to deduct from their revenues and also if they are willing to set this amount to a level that they know is illegal. These tax compliance tasks are manipulated within participants where participants (a) expect the *same* (*happy, angry,* or *neutral*) *tax auditor* they just met to inspect their tax returns of the following year in case of a tax audit, (b) expect *a different, unknown tax auditor* to inspect their tax returns of the following year in case of a tax audit, or (c) expect *no tax audit* for their tax returns of the following year.

The results of the second experiment show that the auditor's expression of both anger and happiness significantly reduces the probability that taxpayers choose a non-aggressive deduction level by 13 to 19 percentage points. Moreover, even if participants know that their tax return will not be audited the emotion effects remain. In this case, the probability of illegally evading taxes is between 16 to 26 percentage points higher for participants that had previously negotiated with an angry or happy tax auditor instead of an emotionally neutral auditor. Because incentives and the opportunity to evade taxes are the same in all three treatments, these results are in line with the interpretation that taxpayers use the emotional behavior of tax auditors to rationalize their tax non-compliance if we assume that fraud is determined by incentives, opportunities, and rationalization (for the so-called fraud-triangle see Murphy and Dacin (2011), Trompeter et al. (2013), Morales et al. (2014)).

Taken together, the two experiments provide causal evidence that tax auditors' emotion expressions affect the outcome of tax audit negotiations and post-audit tax compliance. While the first experiment shows that a tax auditor's expression of happiness leads to less concessions by the taxpayer during audit negotiations, the second experiment reveals an additional disadvantage of expressing happiness: experiencing negotiations with a happy auditor results in greater tax aggressiveness by the taxpayer after the audit. Because the expression of both anger and happiness by the tax auditor results in detrimental effects on taxpayers' post-audit tax compliance, our results point toward the advantageousness of an emotionally neutral auditor behavior. Avoiding emotional expressions does not lead to significantly less concessions by the taxpayer (but more concessions than when expressing happiness), and at the same time does lead to a positive evaluation of the relationship. In fact, the relationship in a negotiation with an emotionally neutral auditor is evaluated only slightly worse than in a negotiation with a happy auditor and significantly better than in a negotiation with an angry auditor. Moreover, an emotionally neutral auditor behavior avoids the negative effects on tax compliance.

Our study contributes to previous research as follows. First, we contribute to the recently growing research on the effects of emotions in accounting (Geng and Kalargiros 2021; Repenning et al. 2022). Prior research on the effects of emotions in accounting-related negotiations is scarce and provides ambiguous results. While Perreault and Kida (2011) find that auditors' positive emotion expressions increase clients' concessions, Bhattacharjee and Moreno (2017) find the opposite in a transfer pricing negotiation between managers as long as incentives to cooperate are missing. Using a tax audit setting, we complement these studies by demonstrating that taxpayers interpret auditors' expression of emotions strategically, which causes asymmetrical responses similar to those found by Bhattacharjee and Moreno (2017). Moreover, our study extends these prior studies by showing that others' emotions not only affect the negotiation outcome but also subsequent decision making of the perceiver of the emotion expressions. We further contribute by explicitly examining not only two emotions but also the absence of these emotions during accounting-related negotiations. From an auditor's point of view, our study indicates that showing no emotions can combine the advantages of showing anger (more auditee concessions) and of showing happiness (better relationship), at least in a competitive setting and when auditees interpret emotional signals strategically.

Second, we contribute to prior tax negotiation and compliance research by providing the first study that investigates the effect of tax auditors' emotions. Prior tax negotiation research has so far only studied the effects of competitive versus cooperative auditor negotiation tactics and of trust. Using survey data, Blaufus et al. (2022) find that tax auditors who employ only competitive negotiation tactics are able to enforce higher additional taxes than auditors who employ only cooperative tactics. However, the advantage of using competitive tactics comes at the cost of a lower agreement probability, which can be avoided by using a combination of competitive and cooperative tactics. In our study, we add the advantages of avoiding emotional auditor behavior. Eberhartinger et al. (2022) experimentally study the effect of trust in a tax negotiation game and find that trust in government increases taxpayers' concessions, whereas interpersonal trust does not influence taxpayers' concessionary behavior. Their result that interpersonal trust does not matter for taxpayers' concessions at first sight might appear surprising. However, it is in line with our findings because we show that negotiating with an auditor who expresses positive emotions increases taxpayers' perceptions of the auditor's trustworthiness and interactional fairness, but that neither trustworthiness nor perceived interactional fairness are associated with taxpayers' concession making. Regarding tax compliance research, our findings provide an additional explanation for why prior studies sometimes found the contra-intuitive result that tax compliance decreases after a tax audit (Beer et al. 2020; DeBacker et al. 2015; Gemmell and Ratto 2012): we find that if taxpayers have experienced an emotionally acting auditor they use this to rationalize subsequent aggressive tax planning and even tax evasion.

Third, using the methods of experimental economics, we add to negotiation research in accounting (e.g., Gibbins et al. 2001; Hatfield et al. 2010; Sanchez et al. 2007) by adjusting a negotiation algorithm that was previously only used in psychology research to a specific accounting context. We also contribute to research by examining whether the predictions of social contagion theory or the EASI model explain negotiation behavior in a tax audit setting. Our findings are clearly in line with the EASI model and call for more research on what conditions symmetrical and asymmetrical responses to others' emotions. Finally, we contribute to research on auditor-client negotiations by suggesting that in negotiations characterized by competition and conflict (e.g., when auditors resort to contending tactics (Gibbins et al. 2010)), anger might benefit the auditor in a similar way as Perreault and Kida (2011) found for "positive" emotions, at least in the short run. However, in light of our findings, the perception of the auditors' emotions (both happiness and anger) might spill over and lead to a rationalization of future non-compliance (e.g., aggressive earnings management) by the client.

Beyond research implications, our study is of relevance for policy makers and auditors who should be informed about the potential detrimental effects of emotions on audit outcomes and compliance. It highlights the relevance of professional negotiation training for tax auditors and shows that avoiding positive emotion expressions may be advantageous in terms of taxpayers' concession making and compliance. Notably, avoiding positive emotion expressions does not hinder the establishment of trustful relationships with the tax auditors as it is the objective in cooperative tax compliance programs (OECD 2013) because taxpayers evaluate emotionally neutral auditors similar as happy auditors with respect to trustworthiness and interactional fairness.

The remainder of the paper is organized as follows. In the next section, we present and discuss the experiment on the effects of tax auditors' emotions on taxpayers' concession making during tax audit negotiations. In the subsequent section, we present and discuss the experiment on the effects of tax auditors' emotions on taxpayers' post-audit tax compliance. The last section concludes and discusses implications for future research and tax policy.

2. Experiment 1: The Effects of Tax Auditors' Emotions on Taxpayers' Concession Making during Tax Audit Negotiations

2.1. Hypothesis Development

Negotiations as a primary means of conflict resolution are inherently emotional[35] (Van Kleef 2014). This should particularly hold for tax audit negotiations because the negotiation outcome may have immediate and severe negative cash flow implications for the taxpayers. While taxpayers have an incentive to avoid additional tax payments, generating additional tax payments is a crucial factor of success in evaluations of tax auditors' work (Alissa et al. 2014). Therefore, tax auditors have an incentive to raise additional taxes. The directional incentives of tax auditors and taxpayers generate opposing directional goals that lead to bias and motivated reasoning (Kadous et al. 2003). Thus, while negotiators should theoretically determine the correct tax liability, they will tend to exploit tax law ambiguity to justify interpretations that are in line with their respective directional goals, which makes conflicts and disputes that trigger emotions highly likely.

The influence of others' emotions in negotiation contexts is subject to different explanatory attempts in prior accounting research. First, Perreault and Kida (2011) rely on social contagion theory (Levy and Nail 1993) and predict that positive (negative) emotion expressions of one

[35] Emotions are discrete affective reactions to a target that are relatively specific, intense, and short-lived, while moods are general affective reactions that are not directed at a target and are relatively diffuse, of low intensity, and are more enduring states of feeling generally good or bad (Cropanzano et al. 2012; Forgas and George 2001; Salovey and Mayer 1989). Affect can be thought of as a generic term used to describe a variety of feeling states, encompassing emotions and moods (Barsade and Gibson 2007; Forgas and George 2001).

party spill over to the other party such that the other party offers greater (less) concessions. In line with their predictions, Perreault and Kida (2011) find that clients who negotiate with an auditor who expresses positive emotions offer 38% more concessions than clients who negotiate with an auditor who expresses negative emotions.

Second, Bhattacharjee and Moreno (2017) rely on the *Emotion As Social Information* (EASI) model, which assumes that emotional expressions provide information and posits that another person's emotion influences the perceiver's behavior via inferential processes and affective reactions (Van Kleef 2009). Inferential processes, on the one hand, may cause the perceiver of another person's emotional expressions to think about the reasons why the other acted in the way he/she did, which may then influence the perceiver's behavioral choices and decisions. Thus, inferential processes involve a strategic interpretation of the sender's emotions. Affective reactions, on the other hand, do not involve this kind of reasoning by the perceiver but are rather driven by subconscious processes[36] in response to the displayed emotional expressions (Van Kleef 2009). The differentiation between inferential processes and affective reactions is necessary because the EASI model postulates that affective reactions to another person's emotional displays give rise to symmetrical effects, i.e., anger (happiness) provokes negative (positive) reactions of the perceiver toward the sender. In contrast, inferential processes give rise to asymmetrical effects, i.e., anger (happiness) provokes positive (negative) reactions of the perceiver toward the sender (Van Kleef 2014). In line with the EASI model, Bhattacharjee and Moreno (2017) find that managers who negotiate on transfer prices offer more concessions if the opponent displays negative emotions than when the opponent displays positive emotions as long as there are no incentives to cooperate.[37]

[36] For example, this may occur via emotional contagion processes or in part through the social intentions and relational orientation that the other person's emotions convey (Van Kleef 2009).

[37] When incentives to cooperate are present, Bhattacharjee and Moreno (2017) find the opposite. They explain their results with the different expectations about the appropriate behavior of others that differs between environments where cooperation instead of competition is the social norm. However, in a traditional tax audit, competitive norms dominate because taxpayers view the tax auditor as an opponent rather than a cooperating partner or advisor.

It is an open empirical question which of these two approaches apply in a tax audit setting. However, according to the EASI model the interpretation of another person's emotional expressions via inferential processes depends on the individual's information processing motivation—or epistemic motivation[38]—which in turn is influenced by the context wherein the interpretation takes place (Van Kleef et al. 2004b; Van Kleef 2014). To assess the likelihood that the information processing motivation is high and, therefore, inferential processes are more likely to occur than affective reactions, we consider the specifics of the tax audit institutional environment in detail. The tax audit environment encompasses most of the components that psychological research associates with increased information processing motivation (e.g., the task is personally involving and taxpayers are held accountable for their decisions), whereas conditions that have been associated with decreased information processing motivation are absent or of low importance (e.g., environmental noise, mental fatigue, high power of the perceiver with respect to the sender) (Van Kleef et al. 2004b). Moreover, tax audit negotiations involve a high degree of uncertainty for both parties (e.g., not knowing the actual aspiration level or the reservation price of the other party, or the existence or size of a bargaining zone) and prior research shows that uncertain negotiation settings lead to more systematic information processing (Van Kleef and Côté 2018). Consequently, we assume that the information processing motivation in a tax audit setting is high and that taxpayers are therefore highly likely to interpret tax auditors' emotional expressions strategically and not to react affectively.

Hence, based on the EASI model, we argue that a tax auditor's display of emotions (happiness, anger, or neutral) will influence a taxpayer's behavior in predictable ways via inferential processes (i.e., via a strategic interpretation of the tax auditor's emotions by the taxpayer). During a tax audit negotiation, a tax auditor's signs of anger are expected to call for the taxpayer's

[38] Epistemic motivation is "[…] the desire to develop and maintain a rich and accurate understanding of the world, including the negotiation task" (Van Kleef et al. 2004b, p.511). In this context, epistemic motivation is also used as a synonym for information processing motivation (Van Kleef 2014).

change in his/her current behavior, i.e., to concede to the tax auditor to appease him/her and prevent the negotiation from failing.[39] In contrast, a tax auditor's signs of happiness are likely to be interpreted by the taxpayer as a sign of weakness because this kind of interpretation seems to be typical in competitive settings (Sinaceur and Tiedens 2006; Van Kleef et al. 2004a, 2004b, 2010). Following this reasoning, a tax auditor's signs of happiness do not call for behavioral change on the taxpayer's side in pursuing his/her directional goals but rather signal the taxpayer to proceed with his/her negotiation tactic, making larger concessions rather unlikely, whereas facing a tax auditor's signs of anger should make concessions more likely instead. This leads to the following hypothesis (stated in alternate form):

H1: A taxpayer facing an angry (a happy) tax auditor in a tax audit negotiation will concede more (less) to the tax auditor.

2.2. Research Method

2.2.1. Procedure

We developed an incentivized computer-based experiment to test hypothesis H1. The experiment was conducted with graduate and advanced undergraduate business students in six sessions at the computerized experimental laboratory of XXX University. The same experimenter (one of the authors) administered all sessions. After entering the laboratory, participants were randomly assigned to their seats. After being seated, participants read the written instructions placed at their table and were given as much time as they required to understand the procedure. In the experimental case, participants assumed the role of the sole owner and managing director of CarSeat-Corporation, who was facing a final audit meeting with his/her tax auditor. Participants read the case material from which they learned about the background of CarSeat, including the current pre-audit income (2,500 €-cents) before consideration of a payment of back taxes from the current company audit with its upcoming final audit meeting. The content of this

[39] Conceding can be seen as the most reliable strategy for complying with the other party's needs (Ben-Yoav and Pruitt 1984).

final audit meeting was about five warranty provisions that the auditor had identified. The tax auditor called for a substantial reduction in warranty provisions, which would reduce the income of CarSeat from the formerly 2,500 €-cents down to 0 €-cents. Precisely, participants learned that the legal position in this case was anything but clear and that there were eleven valuation levels (1-11) for each of the warranty provisions, all of which were legally justifiable but led to different valuations of the warranty provisions. While they—as CarSeat's managing director—had chosen a valuation (level "11" for all provisions) that led to a pre-audit income of 2,500 €-cents, the tax auditor signalled that he deemed appropriate a completely different valuation (level "1" for each of the provisions). The auditor's position would lead to a substantial payment of back taxes, which would cause CarSeat's post-audit income to drop down to 0 €-cents. Participants learned about their payoff structure and that the upcoming negotiation with the auditor would directly influence their payoff (see Table 1).

<<< Insert Table 1 about here >>>

Furthermore, the case material informed participants upfront that they were going to meet the auditor again in another final audit meeting—once they were done with this first meeting[40]—because empirical accounting research has shown that relationship concerns are important in recurring negotiations (Brown-Liburd and Wright 2011; Wang and Tuttle 2009). Additionally, general negotiation literature states that the expectation of a future negotiation interaction creates a functional concern for the other party (Greenhalgh 1999; Mannix et al. 1995; Rubin et al. 1994) and stresses the need for an ongoing relationship (Pruitt and Rubin 1986; Walton and McKersie 1965). Therefore, we expect participants to intensely observe and interpret the auditor's emotions, as these emotions may reflect the current state of the relationship. To limit the number of possible negotiation rounds and add uncertainty about the length of the negotiation,

[40] To avoid any deception of participants, participants again met the same tax auditor in a second tax audit negotiation and again had to negotiate a similar case as in the first negotiation. For further discussion of deception, see Libby and Salterio (2019).

participants were also informed that the auditor had terminated final audit meetings in the past usually between the third and the ninth round and that an agreement had only been accepted by the auditor in the past if all components of a final audit meeting had been agreed upon, which—related to this case—would mean all five provisions.

The case material also stated that if they as participants achieved an agreement with the auditor in the final audit meeting, this result would be binding for the auditor. The better the result they achieved for CarSeat in the final audit meeting, the higher would be their personal payoff that equalled the post-audit income of CarSeat.

Despite the possibility of a negotiated agreement, participants learned that they themselves and the auditor also had the opportunity to abort the final audit meeting at any time with the following consequences. If the auditor aborted the final audit meeting without an agreed result, participants would still be given the opportunity to agree to the last offer of the auditor. If they rejected this option, a tax court would decide on the valuation of the provisions. Similarly, a tax court would decide on the valuation if participants made use themselves of the opportunity to abort the final audit meeting.[41]

A tax court decision was implemented in the experiment by a random mechanism.[42] In the case of a tax court trial, participants had to pay an amount of 200 €-cents to cover the court costs. The court then decided on the valuation of each of the five provisions. Each of the valuation levels (levels 1-11) were possible and equally likely for each warranty provision. Thus, the

[41] This design choice mirrors the fact that tax audit negotiations are always pre-trial negotiations.

[42] This, of course, simplifies the real-world decisions of tax courts, but reflects the great uncertainty that surrounds the prediction of tax court decisions. This uncertainty makes it impossible even for tax experts to predict the outcome of these decisions (Blaufus et al. 2016a).

expected value of the payoff in a fiscal trial amounted to 1,250 €-cents minus 200 €-cents for the court, i.e., to 1,050 €-cents.[43]

After reading the case materials and instructions, participants started the negotiation via a computer-based interface that was programmed and run using the software z-Tree (Fischbacher 2007). Before starting the simulated multi-round negotiation with the auditor to resolve the issues at hand, participants had to answer a few comprehension questions correctly. If they did not answer the questions correctly, a window popped up that explained which question(s) was (were) answered wrongly with the request to answer again. Additionally, participants were invited to raise their hands and ask the experimenter questions if they had any. Thereby, we intended to ensure that every participant really understood the experimental case and procedure. Before entering the actual negotiation screen, participants answered a few questions regarding their perception and expectations of the negotiation situation.

Subsequently, participants accessed the actual negotiation screen where they could enter their offers (see Appendix A for a screenshot). The negotiation lasted for a maximum of six rounds, ending either with an agreement within the six rounds or with one negotiation party terminating the negotiation and leaving the valuation decision for the tax court.

Participants made the first offer and the auditor had to respond to this offer.[44] For each provision, level 1 always yielded 0 €-cents and level 11 yielded the most €-cents for participants: 750 for provision 1, 300 for provision 2, 100 for provision 3, 850 for provision 4, and 500 for provision 5 (see Table 1). Participants were informed that tax auditors in principle have the objective of achieving the highest possible additional tax payments. However, the exact target

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[43] While the expected value of the total payoff amounts to 1,050 €-cents, the possible fiscal trial outcomes could range from 0 €-cents to 2,500 €-cents minus the 200 €-cents of court costs. Due to a fixed show-up fee of 200 €-cents, no participant had to fear a negative total payoff, so that the total payoff in a fiscal trial could range from 0 €-cents to 2,300 €-cents. The case of a total payoff of 0 €-cents did not occur for any participant.

[44] We let participants start with the first offer because the auditor already signaled in the case material that he deemed valuation level 1 appropriate for all the provisions.

structure of the auditor was unknown to the participants. Furthermore, to ensure that participants could not see through the algorithm, we added integrative negotiation items, thereby making the concession behavior of the algorithm more complex and harder to decipher. Unknown to participants, provisions 1 to 4 entailed a moderate amount of integrative potential as the auditor could receive a maximum of 300 €-cents for provision 1, 750 for provision 2, 850 for provision 3 and 100 for provision 4. Therefore, the dyads had the possibility for logrolling (exchanging concessions), which meant to earn more than the obvious solution of compromising by meeting in the middle.[45] The maximum integrative solution would be reached if both parties conceded completely on their "low-value" provisions and insisted on the maximum payoff for their "high-value" provisions.[46] On the other hand, provision 5 was a purely distributive item, which meant that participants and the auditor had completely opposed interests concerning this provision, with no room for logrolling. The auditor's concessions were determined by an algorithm that is based on an algorithm described by Van Kleef et al. (2013) and that we adjusted according to a tax audit negotiation environment (see Appendix B for details). The algorithm was the same for all treatments.

Upon completion of the negotiation, participants answered several questions related to their impressions of the auditor and the negotiation as well as manipulation checks. Afterwards, participants entered the second negotiation with the same auditor. Participants were paid in cash at the end of the experiment. They rolled the dice to determine which of the two negotiations they would receive their payment for.[47]

[45] A simple compromise (level 6 on provisions 1-4) would yield 1,000 €-cents for the participant and the auditor.
[46] The most integrative solution (level 11 on provisions 1 and 4, and level 1 on provisions 2 and 3) would yield 1,600 €-cents for the participant and the auditor.
[47] All participants were informed prior to the start of the first negotiation that they would be paid only for one of the two negotiations to be chosen at the end by themselves through throwing a dice.

2.2.2. Variable Measurement

We used a 3x1 between-subjects design, varying the emotional cues sent by the tax auditor. The three emotion treatments served as *independent variables*. The dummy variable HAPPINESS (ANGER, NEUTRAL) was set to one if a participant was assigned to the *HAPPINESS (ANGER, NEUTRAL)* treatment and zero otherwise. We manipulated the emotional cues by letting the tax auditor express either happy, angry, or emotionally neutral statements (Van Kleef et al. 2004a). On the computer screen, right before the negotiation started, the tax auditor shortly stated the reason for the upcoming negotiation and thereby expressed happiness (anger) about the upcoming interaction or left out any emotional statement (see Appendix C). After participants submitted their first offer to the tax auditor, they saw a blank screen for a few seconds before the tax auditor reacted, which he then did either with a statement of happiness, anger, or no emotion.[48] After another few seconds, the tax auditor's counteroffer was shown to participants below this statement. This procedure was repeated for negotiation rounds one to five unless the auditor or the participant finally accepted (or declined) the counterpart's offer.

We pretested all the statements (reflecting either happiness, anger, or no emotion) that were used during the negotiation.[49] Out of 30 tested statements we selected the three happiness and the three anger statements that had the highest score on the emotion they were supposed to reflect and the lowest score on the emotion they were not supposed to reflect. All selected statements of happiness and anger were rated significantly higher on the emotion they were supposed to express than on the emotion they were not supposed to express according to paired-

[48] The manipulations and the order in which the statements were shown to participants are provided in Appendix C.

[49] We showed 30 different statements (six reflecting happiness, six reflecting anger, and 18 reflecting no emotion) to 328 students at XXX University in an online survey. The statements were presented in random order for each student and students were asked to indicate on a 6-point scale to what extent they felt each statement reflected happiness and to what extent anger (the happiness [anger] scale ranged from 1="no happiness" ["no anger"] to 6="a lot of happiness" ["a lot of anger"]), and additionally whether any other emotions were conveyed with these statements. If any other emotion was recognized (despite happiness or anger), students were asked to label the matching emotion for the specific statement and also to rank this statement on a scale ranging from 1="no other emotion" to 6="very strong other emotion." This methodology is roughly based on Van Kleef et al. (2004a) and Schmidt-Atzert and Hüppe (1996).

sample t tests (all t>50, all p<.01) and according to their respective effect sizes (all *Cohen's d*>3).

Concerning the neutral statements, we selected the three statements that, on the one hand, had the lowest scores on both emotions (happiness and anger) and, on the other hand, for which the differences between the happiness score and the anger score were insignificant. All selected neutral statements were rated equally low on the happiness and anger scale and did not differ significantly according to paired-sample t tests (all t<1.45, all p>.14) and according to their respective effect sizes (all *Cohen's d*<.08).[50]

The primary *dependent variable* is participants' CONCESSIONS, which is measured as the difference (in €-cents) between participants' pre-audit income (i.e., level 11 for all provisions) and the final post-audit income agreed with the auditor. In three cases where participants were unable to reach an agreement, we used the lowest bid from participants to measure CONCESSIONS. An obvious participants' concession behavior would be to agree on the middle (1,250 €-cents) of the pre-audit income (2,500 €-cents) and thus split the difference. We therefore define SPLIT_IN_THE_MIDDLE as a binary variable that equals one if participants conceded half or less of their pre-audit income and zero otherwise. We use this variable as an additional dependent variable to examine participants' success on this strategy—i.e., whether they achieve at least this threshold of half of the pre-audit income for themselves—depending on the emotion treatment conditions.

In multivariate analyses, we use the following *control variables* (see Table 2): Prior negotiation research has shown that a party's negotiation goal highly correlates with the final negotiation

[50] In the second and the following rounds of the negotiation, participants also had to choose on how to react to the tax auditor's counteroffer by picking one from a list of nine statements (three neutral ones, three happy ones, and three angry ones) to articulate toward the auditor before entering their new counteroffer to him. This set of statements was exactly the same set from which the tax auditor's statements were picked to express his happiness, anger, or no emotion. This procedure was designed to enhance the credibility and salience of the statements the auditor was using. Only after the selection of one of the nine statements, participants were given the possibility to type in their counteroffers. Once participants decided to decline the auditor's offer and let a tax court decide, participants did not have to select one of the nine statements.

outcome (e.g., Ben-Yoav and Pruitt 1984; Hatfield et al. 2008; Kelley et al. 1967). Thus, we control for EXPECTATION, which is a metric variable that measures participant's self-reported expected negotiation outcome in €-cents. To determine this amount, participants were asked for each provision separately: "Please use the field 'Expectation' to state the level you actually expect to achieve for each provision." Possible answers range from level 1 to level 11 (see also Table 1). Furthermore, a person's reaction to another person's emotional expressions also depends on the observing person's dispositional sensitiveness to emotions (Lischetzke et al. 2012). We therefore include self-assessments of both, participants' general attention to emotions and how clearly they are able to assign meaning to these emotions (i.e., participants' perceived clarity of emotions) (ATT_CLARITY). ATT_CLARITY is the average answer to the following eight questions adopted from Lischetzke et al. (2012): 1. "I pay attention to other people's feelings," 2. "I pay attention to my feelings," 3. "It is difficult for me to describe my feelings," 4. "I am not sure about what other people actually feel," 5. "I think about how other people feel," 6. "I think about how I feel," 7. "It is difficult for me to describe other people's feelings," and 8. "I am not sure about what I actually feel." Possible answers range from 1="never" to 9="always."[51] A person's negotiation behavior can also be influenced by the perceived relative bargaining power (e.g., Brown-Liburd et al. 2016; Van Kleef et al. 2004b). In line with this research, POWER measures participants' self-reported answer to the following question: "Who do you think has the strongest position in the upcoming negotiation?" Possible answers range from 1="definitely the auditor" to 9="definitely myself." The underlying item is based on Van Kleef et al. (2006). Furthermore, negotiation research has shown that information processing motivation influences the way emotional information is interpreted during a negotiation (e.g., Van Kleef et al. 2013). Thus, INFO_PROCESS measures participants' information processing motivation as the average answer to the following two questions: 1. "I carefully

[51] The questions 3, 4, 7, and 8 are reverse coded. They were inverted for the analysis.

monitored the behavior of the auditor in the negotiation process" and 2. "I monitored the behavior of the auditor in the negotiation process to modify my own behavior accordingly." Possible answers range from 1="does not apply at all" to 9="fully applies." The two underlying items were adopted from Van Kleef et al. (2013). Lastly, we also control for gender given that negotiation research often finds that male and female negotiators approach negotiations differently (e.g., Haselhuhn and Kray 2012; Mazei et al. 2021; Walters et al. 1998). The binary variable MALE takes on the value of one if the participant is male and zero otherwise.

<<< Insert Table 2 about here >>>

2.2.3. Sample Characteristics

A total of 86 students (29 females and 57 males) participated in six sessions in the computer-based experiment that was organized and recruited with the software hroot (Bock et al. 2014) and programmed and conducted using the software z-Tree (Fischbacher 2007). The same experimenter (one of the authors) administered all sessions. Participants all studied at XXX University's economics and management department. Their average age was 23.6 years. We test for differences regarding all control variables between treatments using one-way ANOVAs and non-parametric Kruskal-Wallis-tests. Despite randomization, we find small differences in the control variables between treatments, with all but EXPECTATION being nonsignificant at conventional levels. We include control variables in our multivariate analyses to control for those differences and to prevent distorted results. Participants earned €16.49 on average in approximately 90 minutes (i.e., approximately €11.00 per hour), with a range from €5.90 to €23.30.

2.3. Results

2.3.1. Manipulation Check and Check According to EASI Model

To determine whether we had successfully manipulated the tax auditor's emotions, the post-experimental questionnaire asked participants to rate how much happiness (anger) the tax auditor had expressed in the previous negotiation. Responses for the two questions ranged from

1="no happiness (anger)" to 9="a lot of happiness (anger)." Responses indicate that participants perceived the auditor's emotion statements as intended. In the *HAPPINESS* treatment, the auditor's emotional statements were associated with happiness (mean=6.43), whereas in the *ANGER* treatment happiness was not associated with the auditor's statements (mean=2.32). On the contrary, in the *ANGER* treatment, the auditor's emotional statements were associated with anger (mean=7.43), whereas in the *HAPPINESS* treatment anger was not associated with the auditor's statements (mean=2.46). All differences are significant according to two-tailed t-tests (all $p<.01$). Moreover, participants responded that the auditor's statements in the *HAPPINESS* (*ANGER*) treatment conveyed significantly more happiness (anger) compared to the *NEUTRAL* treatment (two-tailed t-tests, all $p<.01$). Therefore, we conclude that the auditor's emotional statements were successfully manipulated.

Furthermore, to test whether—as theoretically expected according to the EASI model—our tax audit negotiation scenario fosters inferential processes, we measured participants' information processing motivation after the first negotiation on a 9-point scale as described in the variable-measurement section above. As expected, the information processing motivation was perceived as high (mean=7.03) by all participants across all treatments with no significant differences between the treatments. We therefore assume that participants are highly likely to interpret the auditor's emotions strategically due to the high information processing motivation as described by the EASI model.

2.3.2. Participants' Concessions (H1)

We first investigate whether the emotion manipulation of the auditor led to differences in participants' concession behavior as predicted in H1. Figure 1 shows participants' mean concessions for the three experimental conditions.

Participants' mean concession is highest in the *ANGER* treatment (1,124 €-cents) followed by the *NEUTRAL* treatment (1,103 €-cents) and the *HAPPINESS* treatment (994 €-cents). On average, participants in the *ANGER* treatment conceded 13.1% more compared to the *HAPPINESS* treatment and 1.9% more compared to the *NEUTRAL* treatment. The direction of the effect is consistent with our prediction in H1.

<<< Insert Figure 1 about here >>>

In addition, we also examine whether the emotion manipulation of the auditor influences participants' concession behavior such that they agree on at least half of the pre-audit income (2,500 €-cents) or whether they fall below this threshold.[52] Table 3 shows that the majority of participants reached at least half of the pre-audit income, while a minority reached less than half of the pre-audit income, i.e., conceded more than half of their pre-audit income. However, participants in the *ANGER* treatment were three times more likely to fail to reach at least the midpoint than participants in the *HAPPINESS* treatment, and nearly two times more likely than participants in the *NEUTRAL* treatment.

<<< Insert Table 3 about here >>>

To further analyze whether the emotion manipulations significantly affected participants' concession behavior, we conduct multiple linear regressions with CONCESSIONS as dependent variable according to the following equation:

$$\text{CONCESSIONS}_i = \beta_0 + \beta_1\,\text{ANGER}_i + \beta_2\,\text{NEUTRAL}_i + \sum_{k=1}^{l} \beta_k\,\text{Controls}_i + \epsilon_i\,, \tag{1}$$

[52] Altogether, 86 students participated in this experiment in which three participants (two males, one female) failed to achieve a negotiated agreement and let the tax court decide their outcome. We removed these participants from this specific analysis as the tax court decision was purely based on chance. Therefore, the sample for the analyses with SPLIT_IN_THE_MIDDLE as dependent variable consists of 83 participants.

where the betas are the regression coefficients associated with the independent and control variables explained in the variable-measurement section above, and $\in$ is the error term.[53] The *HAPPINESS* treatment serves as the reference and the differences to the treatments *ANGER* and *NEUTRAL* are measured. Hence, the coefficient of ANGER (β_1) expresses how much the concessions vary between the treatments *HAPPINESS* and *ANGER*. A positive coefficient would denote that—as argued in H1—the participants' concessions in the *ANGER* treatment are higher than in the *HAPPINESS* treatment. Likewise, a positive (negative) coefficient of NEUTRAL (β_2) would reveal higher (lower) participants' concessions in the *NEUTRAL* treatment than in the *HAPPINESS* treatment. Table 4 displays the results.

<<< Insert Table 4 about here >>>

Models [1] and [2] in Table 4 reveal that participants in the *ANGER* treatment concede significantly more to the auditor (≈130 €-cents) compared to the *HAPPINESS* treatment (both $p<.1$, two-tailed), supporting H1. Even in the *NEUTRAL* treatment participants concede significantly more compared to the *HAPPINESS* treatment (both $p<.01$, two-tailed). In contrast, no significant difference in concessions can be observed between the *ANGER* treatment and the *NEUTRAL* treatment.

In models [3] and [4] in Table 4, we report the results of binary logistic regressions according to equation (1) with SPLIT_IN_THE_MIDDLE as dependent variable to analyze whether meeting a happy, angry, or emotionally neutral auditor influences participants' likelihood to reach an agreement that does not fall below 1,250 €-cents (i.e., half of their pre-audit income). The results in Table 4 reveal that participants in the *ANGER* treatment do not only offer significantly

[53] In additional analyses, we also controlled for participants' risk attitude. The results in Table 4 remain qualitatively the same but due to a potential post treatment bias (the question was asked after the experimental manipulation), we removed risk attitude from our analyses and only control for risk attitude by using the control variable MALE.

more concessions compared to the *HAPPINESS* treatment (model [1] and [2]), but their probability of reaching at least the midpoint of their pre-audit income (1,250 €-cents) decreases significantly (models [3] and [4]). Average marginal effects (not tabulated) show that participants' probability of reaching an agreement that ensures at least the midpoint of the pre-audit income (≥1,250 €-cents) decreases by 27 percentage points (in model [3]; 28 percentage points in model [4]) in the *ANGER* treatment in comparison to the *HAPPINESS* treatment (p<.05 in model [3]; p<.01 in model [4]). The *NEUTRAL* treatment lies between these two and is not different from the treatments of *HAPPINESS* or *ANGER*.

In sum, despite negotiating against the same negotiation algorithm in all three treatments, the auditor's expressions of anger (or no emotion) increases participants' concessions compared to when they are facing a happy auditor. Even though we added integrative negotiation items in our negotiation scenario to make the concession behavior of the algorithm more complex and harder to decipher (see procedure section above), participants in the *ANGER* treatment conceded so much that almost 40% of these participants (Table 3) failed to agree on at least half of their pre-audit income. These results confirm H1 and clearly contradict standard rational choice predictions. They also contradict social contagion predictions. Rather, the results are in line with the predictions derived from the EASI model. Participants in a tax audit setting strategically interpret the auditor's emotion; when they encounter an angry auditor, they concede more than when they encounter a happy auditor.

2.3.3. Additional Analysis: Effects on the Perceived Relationship

Our results so far show that the auditor's emotion expressions affect taxpayers' concessions. However, the auditor's emotion expressions might also affect the perceived relationship with the tax auditor, which is another dimension that is often examined in financial audit research related to negotiations (e.g., McCracken et al. 2008; Perreault and Kida 2011; Sanchez et al. 2007). In financial audits, the auditor-auditee relationship needs to be considered because the auditor is often seen as the relationship manager, responsible for keeping the auditee satisfied and for retaining this client for the audit firm (McCracken et al. 2008). In tax audits on the other side, retaining the client is not an issue for the Revenue Agency but the Revenue Agency might be interested in improving their public image to enhance the trust in and cooperation with the Agency (OECD 2013). Therefore, a good relationship with the auditees during field audits might also be valued by the Revenue Agency. Therefore, we additionally test whether we find differences in participants' ratings of the relationship with the auditor between the three emotion treatments (*HAPPINESS*, *ANGER*, and *NEUTRAL*).

The relationship with the auditor (RELATIONSHIP) is measured as the average answer to the following three questions 1. "Did the negotiation build a good foundation for a future relationship with the auditor?" (1="not at all", 9="fully"), 2. "How satisfied are you with your relationship with the auditor as a result of this negotiation?" (1="not at all satisfied", 9="fully satisfied"), and 3. "What kind of 'overall' impression did the auditor make on you?" (1="extremely negative", 9="extremely positive"). The items of this index are based on three items out of the "Sixteen-Item Subjective Value Inventory (SVI)" concerning the factor relationship developed by Curhan et al. (2006).

We find that in both, the *HAPPINESS* treatment and the *NEUTRAL* treatment the mean ratings of the relationship to the auditor are positive (*HAPPINESS*: mean=7.07 (SD=1.18); *NEUTRAL*: mean=6.34 (SD=1.48)), whereas participants' mean rating in the *ANGER* treatment is rather negative (*ANGER*: mean=4.31 (SD=1.31)). In Table 4 (models [5] and [6]) we report the results of multiple linear regressions similar to equation (1) but with RELATIONSHIP as dependent variable to analyze whether the aforementioned mean ratings of RELATIONSHIP differ significantly across the treatments. The results for models [5] and [6] in Table 4 reveal that participants in the *ANGER* treatment rate their relationship to the auditor significantly worse compared to the *HAPPINESS* (*NEUTRAL*) treatment. In the *HAPPINESS* treatment, participants' ratings of the relationship are slightly better than in the *NEUTRAL* treatment, nonetheless both ratings tend towards the positive end of the scale.

Concerning the treatments *HAPPINESS* and *ANGER*, these results are in line with prior literature because irrespective of the situation (i.e., competitive, cooperative, or balanced), positive emotions like happiness are most likely to increase interpersonal liking (Kopelman et al. 2006; Van Kleef et al. 2004a, 2004b, 2010), whereas anger most likely provokes negative impressions and reciprocal feelings of anger (Van Kleef et al. 2010). However, participants in the *NEUTRAL* treatment also rated their relationship with the auditor positively, and almost as positively as with an emotionally happy auditor, even though the emotion manipulations in the treatments *HAPPINESS* and *NEUTRAL* were perceived differently (see manipulation check in the results section above). Thus, auditors who wish to enhance the relationship with taxpayers to establish a cooperative compliance environment as recommended by the OECD (2013) do not necessarily need to use positive emotion expressions. Instead, it can be sufficient to be emotionally neutral.

2.4. Discussion of Experiment 1

Confirming H1, our findings of participants' concession behavior support the view of the EASI model that participants interpret the auditor's emotional statements strategically. In the anger treatment, the tax auditor's signs of anger called for participants' change in their behavior, i.e., to concede to the tax auditor to appease him and prevent the negotiation from failing. In the happiness treatment participants made less (or smaller) concessions to the auditor because signs of happiness did not call for behavioral change on the participants' side in pursuing their directional goals but rather signaled to proceed with their negotiation tactic, making larger concessions rather unlikely.

From a theoretical viewpoint, this raises the question why our results differ from the findings of Perreault and Kida (2011) who provide opposite results in the context of client-auditor negotiations. We would expect that in client-auditor negotiations, too, the negotiating parties have a high information processing motivation, which makes a strategic interpretation of the auditor's emotion highly likely. However, one important difference between financial statement auditors and tax auditors is the higher importance of relationship management for financial statement auditors. Perreault and Kida (2011, p.539) note that "the auditor–client relationship typically extends over a long period of time and clients often view auditors as trusted advisors who have a shared responsibility for issuing accurate financial statements." Also, tax auditors of large firms usually meet the taxpayer again and we explicitly instructed our participants that they would negotiate in another tax audit meeting with the same auditor. Moreover, we also provided for opportunities to exchange concessions so that both sides could benefit. However, in traditional tax audits, taxpayers do not consider the tax auditor as a partner or an advisor but as an opponent. This is confirmed by our pre-manipulation questions. Participants stated that they perceived the upcoming negotiation as not cooperative/collaborative but rather competitive/conflictual (on a 9-point scale ranging from 1="not at all" to 9="very much" with a mean on cooperative/collaborative of 4.2 and a mean on competitive/conflictual of 6.4). Thus, the different results between the examined tax audit setting and the setting of client-auditor negotiations might be due to the different prevailing social norms with a more cooperative norm in client-auditor relations than in taxpayer-tax auditor relations. This interpretation is supported by the findings of Bhattacharjee and Moreno (2017) who provide evidence that introducing incentives for cooperation results in symmetric emotional responses while in the absence of these incentives asymmetric responses (as those observed in our study) occur.

Our findings are based on participants' expectation to meet the same auditor again. Without this expectation—as was the case in a preceding negotiation of Experiment 2, where participants negotiated with a tax auditor who they did not expect to meet again—we found no significant differences in participants' concession behavior between the three emotion treatments.[54] This result is in line with prior empirical accounting literature that has shown the importance of relationship concerns in recurring negotiations (Brown-Liburd and Wright 2011; Wang and Tuttle 2009). Thus, the effect of emotions on negotiation outcomes seems to exist only for recurrent audits, implying different effects for firms with continuous tax audits and firms that are audited only occasionally.

Regarding the implication for tax audit practice, our results highlight the advantage of avoiding emotional expressions. When faced with an emotionally neutral auditor, participants' concessions were not significantly lower when confronted with an angry auditor and higher than when they negotiated with an auditor showing signs of happiness. However, avoiding the expression of emotion resulted in a better rating of the relationship than expressing anger and only a slightly worse rating than expressing happiness. Thus, the emotionally neutral acting auditor seems to attain desirable taxpayer reactions on both concessions and relationship ratings.

One potential objection against the results reported above might be that we use business students as participants and not experienced managers or tax professionals. However, with respect to our research questions, using business students offers the important advantage that it increases the internal validity because we can better control participants' preferences through monetary rewards. This creates an environment in which rational choice models should work best. If we still find evidence that emotions matter in this setting, this can be considered particularly strong evidence, since the effect of emotions should be even stronger in a more realistic setting where participants negotiate face-to-face instead of against an algorithm. Moreover, prior research shows that the effect of emotions in negotiations generalizes over different samples such as students, the general population, and business managers (Van Kleef et al. 2004b;

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54 However, we did find spillover effects in a subsequent tax compliance task (see next section).

Van Kleef et al. 2006). Therefore, the usage of business students should not considerably restrict the external validity. Nevertheless, to test whether our result that expressing happiness rather than anger results in less concessions from the taxpayer carries over to real tax audit cases, we exploit the tax audit survey data from Blaufus et al. (2022) with the explicit permission of those authors. Blaufus et al. (2022) collected data from tax auditors about their two most recent cases. Their sample includes 572 audited firms, in which face-to-face negotiations between auditors and taxpayers took place. While the authors did not directly ask for emotions, they, however, collected information on whether the auditors rated the atmosphere during negotiations as "friendly, cooperative, and constructive" or as "unfriendly and reproachful." Following the approach of Blaufus et al. (2022), we use multivariate linear regressions to explain the logarithmic additional taxes assessed in the audit using firm and tax auditor characteristics. However, instead of negotiation tactics, we include as independent variable a binary variable (FRIENDLINESS) that equals one when auditors described the atmosphere as "friendly, cooperative, and constructive" and zero otherwise. Assuming that this variable is a reasonable proxy for positive auditor emotion expressions, the analysis confirms our experimental findings. If the atmosphere is "friendly, cooperative, and constructive" the additional taxes assessed in the tax audit significantly decrease (see Table D.1 in Appendix D).

An obvious empirical question that arises is whether taxpayers' experiences with an auditor expressing emotions influence their subsequent behavior. Our Experiment 2 that is reported next takes up precisely this point and explores the question whether and how taxpayers' experience with an emotionally acting tax auditor can influence their future tax compliance.

3. <u>Experiment 2</u>: The Effects of Tax Auditors' Emotions on Post-Audit Compliance of Taxpayers

3.1. Hypothesis Development

Prior research shows that the experience of an audit may change subsequent taxpayer compliance. Surprisingly, this research finds both taxpayers that increase their compliance after an audit (e.g., Li et al. 2019) and taxpayers that reduce their compliance (Beer et al. 2020; DeBacker et al. 2015; Gemmell and Ratto 2012). Why some taxpayers increase their non-compliance after an audit experience is not clear (Beer et al. 2020). Some authors refer to belief updating with respect to an auditor's abilities (Finley 2019; Gemmell and Ratto 2012), others to misperceptions regarding the future audit probability or to a "loss-repair motivation" (Maciejovsky et al. 2007; Mittone et al. 2017). The survey findings of Enachescu et al. (2019) suggest that negative emotional experiences during a tax audit (such as anger) are related to lower post-audit compliance intentions. In our second experiment, we adopt the idea that emotional experiences during a tax audit can determine later compliance behavior. In particular, we examine the effect of tax auditors' emotions on post-audit compliance of taxpayers.

The results of Experiment 1 suggest that taxpayers interpret auditors' emotions strategically.[55] However, this does not mean that the auditor's emotional expressions do not also elicit affective reactions in taxpayers which may then influence subsequent behaviors (Wang et al. 2012). Thus, positive emotions of the tax auditor may spill over to the taxpayer and positive emotions of taxpayers have been shown to decrease tax compliance (Fochmann et al. 2023). Tax non-compliance is usually associated with negative emotions such as shame and guilt (e.g., Blaufus et al. 2017). Fochmann et al. (2023) argue that positive incidental background emotions counteract these negative integral emotions that arise from being non-compliant and thus positive background emotions result in higher non-compliance. In addition, the auditor's emotion expressions may be interpreted as information about the underlying tax enforcement policy of the government. For example, happiness of the tax auditor might signal that tax aggressiveness and even illegal tax evasion are not a severe problem for the government and that the government

[55] The happiness (anger) of an auditor seems to be interpreted as a signal that the auditor is a "weak" ("tough") negotiator. Thus, taxpayers may expect a higher (lower) probability that the tax authority in a future audit will accept a tax treatment of an accounting issue. This would result in a higher (lower) aggressiveness of future tax planning. In this vein, Hartner et al. (2010, 12) argue that "tax officers being too nice to their clients would provoke deviant behavior because of the lacking threat of penalties." However, our experimental design provides participants with objective data on the probability that the auditor does not accept a specific tax planning level, so that we can exclude this behavioral channel.

does not exert rigorous coercive power to prevent them, which may trigger taxpayers to consider tax aggressiveness and even illegal tax evasion as not being a severe crime. Thus, the expression of positive emotions by the tax auditor may be interpreted in a way that it helps taxpayers rationalizing their tax aggressiveness. Rationalization has long been considered an important determinant of fraud because individuals use rationalization to avoid or reduce the negative emotions that arise when engaging in unethical behavior (Murphy and Dacin 2011) and to maintain a positive self-concept (Mazar et al. 2008). While the two lines of reasoning mentioned so far would imply a higher tax aggressiveness after experiencing an auditor expressing happiness, tax auditors' displayed positive emotions may also produce a favorable climate between taxpayers and the tax authority with higher perceived interactional fairness and trustworthiness of the auditor. Both, interactional fairness and trustworthiness have been shown to promote voluntary tax compliance (Batrancea et al. 2019; Kirchler 2007; Wenzel 2006). In sum, it is an empirical question whether the compliance-increasing or decreasing effect dominates. Therefore, we state the following non-directional hypothesis:

H2: A taxpayer facing a happy tax auditor in a tax audit negotiation will change the aggressiveness of subsequent tax planning.

On the one hand and similar to the above argumentation, also the tax auditor's anger may spill over to the taxpayer's emotions, and previous research has shown that individuals contribute less to public goods when they are angry (Drouvelis and Grosskopf 2016), suggesting that taxpayers will increase their aggressiveness in post-audit tax planning when they have negotiated with an angry auditor in the past. In addition, taxpayers might perceive the auditor's anger as inappropriate and feel unfairly treated. This reduction in interactional fairness could reduce their trust in the tax authority and crowd out their intrinsic motivation to comply (Beer et al. 2020; Enachescu et al. 2019; Feld and Frey 2007). In this vein, prior research reports that negative emotional experiences, in particular feelings of disrespect and mistreatment, are often associated with retaliatory behaviors (Wang et al. 2012). Moreover, the tax auditor's expressed anger may be interpreted as information about the government's tax enforcement policy. In particular, expressed anger may signal that the government tries to exploit its citizens and is abusing its power. As retaliation is one typical category of rationalizing unethical behavior (Murphy and Dacin 2011), individuals may feel that tax aggressiveness is justifiable in this case. On the other hand, anger as negative emotion might not compensate (via rationalization as just portrayed) but amplify the negative emotions arising from non-compliant behavior (shame and guilt), leading to higher compliance. In line with this, Fochmann et al. (2023) find that inducing negative emotions increases tax compliance. As there are arguments for a compliance-increasing or decreasing effect, we state the next non-directional hypothesis:

H3: A taxpayer facing an angry tax auditor in a tax audit negotiation will change the aggressiveness of subsequent tax planning.

3.2. Research Method

3.2.1. Procedure

Participants of Experiment 2 first had to complete a preceding experiment whose task was the same negotiation that was also used in Experiment 1 reported above. This preceding experiment served as the between-subjects manipulation for our Experiment 2 by letting participants experience a preceding negotiation with either a happy, angry, or emotionally neutral tax auditor. Participants then opened a second envelope that includes the instructions concerning Experiment 2. They were told that they were again taking on the role of the sole owner and managing director of CarSeat-Corporation, and had to prepare the current tax return. Moreover, participants were informed that they now had to decide upon the amount of tax deductions they liked to claim for some operating expenses of CarSeat. The higher the deductions were set, the less tax CarSeat would have to pay and vice versa. In this fiscal year, CarSeat had earned a profit of 1,750 €-cents. The current tax rate of CarSeat was 40%. Without tax deductions, CarSeat would have to pay taxes amounting to 700 €-cents (1,750 €-cents x 40%) and, therefore, could collect 1,050 €-cents as after-tax profit.[56]

Participants were then told that they had 16 possibilities to report tax-deductible operating expenses for CarSeat ranging from giving up any deductions (level 0) to deducting a legally allowed amount (levels 1 to 10) up to deducting an illegal amount (levels 11-15, see Table 5). While the exact height of legally deductible operating expenses is not regulated clearly, participants could clearly see that, as the deduction increases, the likelihood that the position will be audited and not accepted by the tax authority increases (see the second column in Table 5). Participants' experimental payoff depended on the after-tax profit of CarSeat. We follow standard tax compliance games and calculate the profit without audit and with audit as follows:

No audit: $1{,}050 + \tau \cdot D$ (2)

Audit: $1{,}050 - \begin{cases} \tau \cdot D \cdot f, \text{ legal (level 0-10)} \\ \tau \cdot D \cdot F, \text{ illegal (level 11-15),} \end{cases}$ (3)

with $\tau = 0.40$ denoting the tax rate, D the amount of tax deductions, $f = 0.2$ penalty interest payments in case of legal, but not accepted tax planning, and $F = 1$ the penalty rate in case of detected tax evasion. All participants were informed about these payoffs as shown in columns [4] and [5] in Table 5. In addition, the decision screen again informed subjects that choosing a level between 11 and 15 is considered illegal tax planning.

<<< Insert Table 5 about here >>>

Participants were told that they had to make three decisions and that one out of these three decisions would be randomly chosen at the end of Experiment 2 to determine their payoff.[57] Before the first decision started, participants were informed that a potential tax audit would be conducted by the same auditor with whom they had previously negotiated (i.e., in the preceding

[56] The instructions explained that all tax payments in this experiment would accrue to XXX University and YYY University, where they would be used for further scientific projects.

[57] Since only one of the three decisions was relevant to participants' payoff, participants could make these decisions independently.

experiment as explained above). Afterwards, the decision screen displayed Table 5 and participants made their decision about the tax deduction level.

For the subsequent second decision, participants were asked to imagine the following scenario: Another auditor, whom they had never met before and accordingly cannot assess, would conduct a possible tax audit. Participants again saw the decision screen that displays Table 5 and made their decision.

Before their third decision, participants were informed that they should imagine the following scenario: The tax authorities were already working at full capacity in this calendar year, so that tax deductions would not be subject to audit. The decision screen then displayed again Table 5, but this time without column [5]. After finishing the last decision, a random algorithm decided which of the three decisions determined participants' payoff for this experiment. Participants were paid in cash at the end of the experiment. They rolled the dice to determine which of the two experiments (i.e., either the preceding negotiation experiment or Experiment 2 with the tax compliance task) they would receive their payment for.[58] However, before the experiment ended participants had to answer several questions regarding their tax morale, perception of social norms, and their attitude toward the tax administration.

This 3x3 mixed within-between-subjects design allows us to test H2 and H3 by comparing the level of tax aggressiveness between participants. In particular, we are able to examine whether the emotional state of the auditor leads to taxpayers exploiting the borders of legal tax planning to the maximum or even engaging in illegal tax planning (tax evasion). This is important because prior research has shown that the definition of illegality significantly affects participants'

[58] All participants were informed before the preliminary experiment (i.e., the negotiation) started that they would be paid only for one of the two experiments to be chosen at the end by themselves through throwing a dice. Compared to the alternative of both experiments being paid off, this arrangement has the advantage that the payoffs from the first experiment should not affect the behavior in the second experiment. Thus, we can exclude what is known as "loss-repair motivation" (Maciejovsky et al. 2007) for an increasing non-compliance after a tax audit.

judgments and behavior (Blaufus et al. 2016b; Blaufus et al. 2019; Kirchler et al. 2003). Moreover, we can analyze whether the emotional audit experience affects compliance behavior when taxpayers expect to meet the same auditor again, a different auditor, or not be audited at all.

This within-subjects manipulation reflects well the different audit realities, as there are companies that are continuously audited and therefore often meet with the same tax auditor more than once, whereas there are also many companies that expect to never meet with the same auditor again or have a probability close to zero of being audited. Furthermore—by explicitly presenting objective probabilities that a particular tax deduction will not be accepted by the tax authority and the resulting payoffs—we ensure that potential treatment effects are not simply due to differences in expected audit outcomes or a misperception of audit probabilities.

3.2.2. Variable Measurement

To test H2 and H3, we use the following *dependent variables*. First, AGRESSIVENESS equals the level of tax deductions participants chose ranging from 0 (no deductions) to 15 (maximum tax deductions). Second, to consider that the legality of tax planning serves as important anchor for participants, we also use AGGRESSIVENESS_3 as dependent variable. AGGRESSIVENESS_3 is a categorical variable that equals one (two, three) if participants chose a deduction level that is below the maximum legal amount (is equal to the maximum legal amount, is illegal). Third, in some specifications, we further use the variable EVASION, a binary variable that equals one if participants chose an illegal deduction level (levels 11 to 15) and zero otherwise.

As in Experiment 1, the three emotion treatments of the preceding experiment serve as *independent variables*. The dummy variable HAPPINESS (ANGER, NEUTRAL) equals one if a participant was assigned to the *HAPPINESS (ANGRY, NEUTRAL)* treatment and zero otherwise. In addition, the categorical variable AUDITOR measures whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated (*SAME*), by another auditor (*OTHER*), or would not be audited at all (*NOAUDIT*).

In multivariate analyses, we use the following *control variables.* Prior compliance research shows that participants' individual tax morale determines the individual tax aggressiveness (e.g., Alm and Torgler 2006). In line with this research, we include the variable MORALE_ILLEGAL, which is determined based on an item from the World Values Survey that asks participants: "Please tell me for the following statement whether you think it can always be justified, never be justified, or something in between: 'Cheating on taxes if you have the chance.'" Likewise, to measure participants' attitude toward legal tax planning, we include the variable MORALE_LEGAL, which is determined based on a similar item that asks participants whether they think taking advantage of legal loopholes to save on taxes—when given the opportunity—is justifiable (Blaufus et al. 2015). Possible answers to both items range from 0 ("never justifiable") to 9 ("always be justified"). The variables MORALE_ILLEGAL and MORALE_LEGAL, respectively, equal one if a participant's answer to the underlying item does not exceed the first quartile and zero otherwise. Finally, we also control for gender given that research often finds that male participants tend to be more non-compliant (Kastlunger et al. 2010) and less financially risk-averse (Charness and Gneezy 2012). The binary variable MALE takes on the value of one if a participant is male and zero otherwise.

3.2.3. Sample Characteristics

A total of 85 students participated in seven sessions in the computer-based experiment conducted in the experimental laboratory of XXX University. All participants studied at the university's economics and management department. The experiment was programmed by using the software z-Tree (Fischbacher 2007) and participants were recruited with the software hroot (Bock et al. 2014). Five participants failed to give the correct answer to the post-experimental question concerning the level from which the operating expense deduction was illegal. After removing these participants, we obtain a final sample of 80 participants (67.5% male, 32.5%

female) with an average age of 22.98 years. We tested for differences regarding all control variables between treatments using one-way ANOVAs and non-parametric Kruskal-Wallis-tests and could not detect any significant differences between treatments. Participants earned €17.76 on average in approximately 90 minutes (i.e., approximately €11.84 per hour), with a range from €9.50 to €23.30.

3.3. Results

To first test whether we had successfully manipulated (between subjects) the tax auditor's emotions, we asked participants to indicate which emotions the tax auditor had expressed in the preceding negotiation. The answers ranged from 1="no happiness (anger)" to 9="a lot of happiness (anger)." The responses confirm the intended manipulation. Participants respond that the auditor's statements in the *HAPPINESS* (*ANGER*) treatment conveyed significantly more happiness (anger) compared to the *ANGER* (*HAPPINESS*) treatment (two-tailed t-tests, all p<.01). Moreover, participants responded that the auditor's statements in the *HAPPINESS* (*ANGER*) treatment conveyed significantly more happiness (anger) compared to the *NEUTRAL* treatment (two-tailed t-tests, all p<.01).[59]

The descriptive results are displayed in Table 6 and in Figure 2. We find a significantly higher tax aggressiveness (AGGRESSIVENESS) when participants had negotiated with a tax auditor expressing happy emotions compared to a neutral auditor (two-tailed t-tests, all p<0.1), regardless whether participants expected to meet the same auditor, expected to meet another auditor, or knew that they would not be audited at all.

This is in line with H2 that predicted that a taxpayer facing a happy auditor in a tax audit negotiation would change the aggressiveness of subsequent tax planning. In contrast, we do not

[59] *HAPPINESS*: mean responses "happy"=6.32 ("angry"=2.56), *ANGER*: mean responses "happy"=2.46 ("angry"=7.57), *NEUTRAL*: mean responses "happy"=3.70 ("angry"=2.96).

observe any significant differences in AGGRESSIVENESS between participants who negotiated with an angry auditor and a neutral auditor.

Using the variable AGGRESSIVENESS, however, does not consider the fact that the experimental design distinguishes between legal and illegal levels of tax deductions. Figure 2 shows that while many participants chose an illegal amount of tax deductions, the percentage of evaders is always the lowest if participants had negotiated with an emotionally neutral auditor. This suggests that emotional auditors have a detrimental effect on post-audit tax compliance. Moreover, it is noteworthy that at least one third in the *NEUTRAL* treatment decides not to evade even if there is no detection risk at all (AUDITOR=*NOAUDIT*). This sharply contrasts standard rational choice models of tax compliance and underlines the importance of legal norms in defining anchors for moral behavior which accords with the theory of expressive law as participants attach a psychological penalty to a forbidden act (Cooter 1998). This moral behavior is reduced in both emotion treatments as the percentage of non-evaders decreases to less than 20%.

<<< Insert Table 6 about here >>>

<<< Insert Figure 2 about here >>>

To test whether the emotion manipulations significantly affected participants' decisions between evasion (deduction levels 11 to 15), maximum avoidance (deduction level 10), and lower levels of tax avoidance (deduction levels <10), we conduct multinomial logistic regressions with AGGRESSIVENESS_3 as dependent variable to predict the probability that participant *i* chose the outcome *k* (*k*=1: avoidance below maximum, *k*=2: maximum avoidance, *k*=3: evasion) according to the following equation:

$$\begin{aligned} \mathrm{AGGRESSIVENESS\_3}_{ik} &= \beta_{0k} + \beta_{1k}\mathrm{HAPPINESS}_i + \beta_{2k}\mathrm{ANGER}_i + \beta_{3k}\mathrm{MALE}_i \\ &+ \beta_{4k}\mathrm{MORALE\_ILLEGAL}_i + \beta_{5k}\mathrm{MORALE\_LEGAL}_i + \epsilon_{ik}\ , \end{aligned} \tag{4}$$

where the betas are the regression coefficients associated with the independent and control variables explained in the variable-measurement section above, and $\in$ is the error term. Table 7 displays the results. Average marginal effects are shown in Table 8. Because there are almost zero observations with $\text{AGGRESSIVENESS\_3} = 1$ (i.e., avoidance below maximum) for the condition *NOAUDIT*, we estimate equation (4) in this case using a binary logistic regression with EVASION as dependent variable.

<<< Insert Table 7 about here >>>

Table 7 reveals that, compared to the *NEUTRAL* treatment, assigning participants to an angry (*ANGER* treatment) or happy tax auditor (*HAPPINESS* treatment) increases the probability that participants evade taxes or choose the maximum amount of tax avoidance in post-audit tax compliance decisions. The average marginal effects (Table 8) show that the probability of choosing a level below the maximum amount of tax avoidance decreases by 13 to 19 percentage points in the two emotion treatments compared to the *NEUTRAL* treatment when participants expect to be audited. Moreover, if participants know that they will not be audited the probability to evade taxes increases by 16.4 (26.0) percentage points in the *ANGER* (*HAPPINESS*) treatment. These results confirm H2 and H3; participants who encounter an emotional auditor change their subsequent tax compliance behavior. Note that we do not find significant differences between the *ANGER* and *HAPPINESS* treatments (Wald-tests, see Table 7).

<<< Insert Table 8 about here >>>

To test whether there are differences within the emotion treatments with respect to the variable AUDITOR, we conduct logistic panel regressions with random-effects within each of the three emotion treatments. The variable EVASION serves as dependent variable and we include AUDITOR as independent and MALE and MORALE_ILLEGAL as control variables. The results (untabulated) show that in all three treatments (*HAPPINESS*, *ANGER*, *NEUTRAL*) the probability to evade in the AUDITOR=*NOAUDIT* condition significantly exceeds the probability to evade taxes in the conditions AUDITOR=*SAME* and AUDITOR=*OTHER*. This is expected and confirms the deterrent effect of audits. Moreover, the probability to evade taxes in the *ANGER* and *NEUTRAL* treatments does not depend on whether participants expected to be audited by the same or an unknown tax auditor. However, the probability to evade taxes was significantly lower in the *HAPPINESS* treatment (average marginal effect: 32 percentage points) if participants expected to meet a different auditor rather than the same auditor with whom they had previously negotiated. This suggests that participants in the *HAPPINESS* treatment believed that different auditors would treat taxpayers differently and that their own experience with a happy auditor might not reflect the average auditor's behavior.

In sum, the results confirm hypotheses H2 and H3. Participants facing an angry or a happy tax auditor in a tax audit negotiation change the aggressiveness of subsequent tax planning. In both cases, the auditor's emotion expressions increase participants' post-audit tax aggressiveness and this holds even when participants know that they will not be audited at all.

3.4. Discussion of Experiment 2

Experiment 2 shows that both the expression of anger and happiness by the tax auditor result in detrimental effects on taxpayers' post-audit tax compliance. These findings confirm hypotheses H2 and H3, but raise the question of why both opposing emotion expressions increase taxpayers' planning aggressiveness.

In the hypothesis development, three potential channels were distinguished. First, the auditors' emotions may have affected participants own emotions that mediate the effect on their tax aggressiveness. To test this channel, we use two questions regarding participants' own anger and happiness during the previous tax audit negotiation, which were asked at the end of the preceding experiment.[60] The answers are displayed in Table 9. As expected, participants in the *HAPPINESS* treatment felt significantly more happiness than participants in the treatments *ANGER* (two-tailed t-test, $p<.01$) and *NEUTRAL* (two-tailed t-test, $p<.05$). Thus, the auditor's expression of happiness spilled over to participants' own emotion. In contrast, we do not find a significant difference regarding own anger between the three emotion treatments. To test whether there is an association between own emotions and AGGRESSIVENESS_3, we conduct regressions according to equation (4) but instead of the treatment variables we include OWN_HAPPINESS and OWN_ANGER, respectively. The results are displayed in Table 10 and show no significant association between own emotions and participants' tax planning behavior. In additional (unreported) tests, we include both the treatment variables and the own emotions in the regressions. We find the results regarding the treatment variables to be unaffected and the effects of own emotions to be insignificant. In sum, these findings show that the feelings of own anger and happiness do not drive participants' tax aggressiveness.

Second, another potential channel that could explain the effect of the auditor's emotion expressions on participants' tax aggressiveness is the effect on perceived interactional fairness. Participants who had previously negotiated with an angry (happy) tax auditor may have perceived to be unfairly (fairly) treated and this may have resulted in higher (lower) tax aggressiveness. We measure interactional fairness (FAIRNESS) using three question that were asked after the preceding negotiation experiment.[61] The answers are displayed in Table 9. As expected, participants in the *ANGER* treatment felt significantly less fairly treated by the auditor compared to

[60] Participants answered the following question: "Which emotions do you feel when thinking about the past negotiation?" regarding happiness (anger) on a 9-point scale, ranging from 1="no happiness (anger)" to 9="a lot of happiness (anger)."

[61] Participants answered the following questions on a 9-point scale: 1. "What do you think: how much has the auditor tried to be fair to you?" (1="not at all", 9="very much"), 2. "Would you characterize the negotiation process as fair?" (1="not at all", 9="fully"), and 3. "How much do you believe the auditor wanted to reach a mutually acceptable agreement?" (1="not at all", 9="very much"). We use the average answer to these three questions as measure for the perceived interactional fairness (FAIRNESS).

participants in the treatments *HAPPINESS* (two-tailed t-test, p<.05) and *NEUTRAL* (two-tailed t-test, p<.05). Thus, despite negotiating against the same negotiation algorithm in all three treatments, the auditor's expression of anger reduced the perception of interactional fairness. In contrast, participants did not differ in their fairness evaluation between the *HAPPINESS* and *NEUTRAL* treatments. As in the previous analysis on the potential mediation of own emotions, we test whether there is an association between FAIRNESS and AGGRESSIVENESS_3 and thus conduct regressions according to equation (4) but instead of the treatment variables we include FAIRNESS as independent variable. The results show no significant association between FAIRNESS and participants' tax planning behavior (see Table 10). In additional (unreported) tests, we include both the emotion treatment variables and FAIRNESS in the regressions and find the results regarding the treatment variables to be unaffected and the effects of FAIRNESS to be insignificant. Overall, these findings show that interactional fairness does not explain the observed treatment differences in participants' tax aggressiveness.[62]

Third, because the treatment differences are neither due to differences in own emotions nor in perceived interactional fairness, our results suggest that the auditor's emotion expressions serve as rationalization for immoral behavior, i.e., they reduce own moral costs and the related feelings of shame and guilt caused by illegal behavior. According to the so-called fraud-triangle that is used by auditors to assess fraud risk (Morales et al. 2014; Murphy and Dacin 2011; Trompeter et al. 2013) fraud can be explained by incentives, opportunity, and rationalization. Incentives and opportunity to evade taxes are the same in all three treatments, but the experience of a happy auditor may signal that tax non-compliance is not a severe problem for the government and that the government does not exert rigorous and uniformly strict coercive power to

[62] The auditor's emotion manipulation significantly affected participants' perceived trustworthiness of the auditor. Trustworthiness was measured as the answer to the following question: "Do you consider the auditor as trustworthy?" (1="not at all trustworthy", 9="fully trustworthy"). However, similar to the presented results above trustworthiness is not significantly associated with the observed tax planning behavior.

prevent it.[63] This may be used as a justification by participants to increase their tax aggressiveness. Negotiating with an angry tax auditor may, on the other hand, signal that the government tends to exploit its citizens and is abusing its power. Retaliation—here in the form of tax evasion—may thus be perceived as justifiable and thus used as rationalization (Murphy and Dacin 2011, p.611). Therefore, in both cases, the emotional behavior of the tax auditor provides participants with an opportunity to rationalize their illegal behavior so that they are able to maintain a positive self-view in terms of being a moral person despite engaging in actually immoral behavior (Mazar et al. 2008). Similar to Experiment 1, participants seem to perceive the auditors' emotions as signal that have to be interpreted. In a negotiation context (Experiment 1), emotions of the opponent's party are interpreted as signals regarding the opponent's negotiation goals and limits. In a tax compliance context (Experiment 2), the auditor's emotions in a prior tax audit seem to be interpreted as information about the government's tax enforcement policy. These findings clearly show that others' emotions matter for own behavior and affect not only immediate responses but also subsequent decision making. The government and each tax auditor should be aware that the expression of emotions might have detrimental effects on tax audit outcomes as well as post-audit taxpayer compliance.

<<< Insert Table 9 about here >>>

<<< Insert Table 10 about here >>>

4. Conclusion

This study provides causal evidence on the effect of auditors' emotion expressions during tax audits on the negotiated outcome and taxpayers' post-audit compliance. We find that expressing anger increases taxpayers' concessions compared to expressing happiness. These findings are in line with the predictions derived from the *Emotion As Social Information* (EASI) model (Van

[63] The significant reduction in the probability to evade taxes in the *HAPPINESS* treatment when participants expected to meet another auditor (compared to be audited by the same happy auditor) suggests that participants expected different auditors to treat taxpayers differently and, thus, that the government does not exert uniformly strict coercive power.

Kleef 2009) and its underlying theory as adapted and applied to the tax audit negotiation environment. This means that in tax audit negotiations, which involve a high degree of uncertainty for both parties and a high epistemic motivation of the negotiation opponents, something as natural as showing emotion will be interpreted strategically by the other party and thereby affect the outcome of these negotiations—particularly the resulting tax payments—and the relationship to the other party in predictable ways.

Our findings are in contrast to prior results reported for client-auditor negotiations (Perreault and Kida 2011) and thus highlight the importance of context. We argue that the relationship between financial statement auditors and their clients may be perceived as more cooperative than the relationship in a traditional tax audit setting. This interpretation is supported by the findings of Bhattacharjee and Moreno (2017). They show that in more cooperative environments symmetrical emotional responses dominate, i.e., displaying anger (happiness) results in less (more) concessions of the other party, whereas in the absence of these incentives the opposite is observed, i.e., displaying anger (happiness) results in more (less) concessions of the other party. The latter is exactly what we find.

In addition, we find that auditors who behave emotionally neutral obtain taxpayer concessions that are not significantly lower than auditors expressing anger and higher than auditors expressing happiness. Moreover, auditors who avoid emotional expressions receive better ratings on the relationship dimension than auditors expressing anger and only slightly worse ratings than auditors expressing happiness. Thus, looking only at the negotiation setting, showing no emotions seems to be the superior alternative from a tax auditor's point of view. This is in line with literature that emphasizes the detrimental effects of emotions on negotiations (e.g., Cropanzano et al. 2012; Thompson et al. 2001).

Moreover, the disadvantage of showing emotion during tax audit negotiations is supported by the results of the second experiment reported in this paper, which shows that both anger and happiness significantly increase post-audit tax noncompliance.

Our study informs researchers, policymakers, and auditors about the important impact that intentional and unintentional emotional expressions by tax auditors can have on negotiation outcomes and on subsequent taxpayer compliance. Future research might extend this study by examining other emotions such as anxiety and fear on tax audit negotiations. Moreover, future research might also investigate the effect of emotions on the probability to find an agreement. In the current negotiation experiment, we were interested in the amount of concessions and therefore set the incentives in a way that made an impasse rather unlikely. However, the results of Blaufus et al. (2022) suggest that emotions may significantly affect the agreement probability, which would be important for firms and tax auditors who both strive to avoid lengthy and uncertain tax court procedures. Additionally, the impact of context deserves further research. For tax policy, it would be of interest whether one could change the results reported in this study by changing the social norm from a competitive to a more cooperative environment, as envisioned in horizontal monitoring programs (Huiskers-Stoop and Gribnau 2019). Furthermore, in financial auditing where financial auditors have been identified as relationship managers (McCracken et al. 2008), there are still different types of auditors and not all auditors are likely to consistently display positive emotions. Depending on the circumstances, financial auditors also resort to contending tactics in negotiations (Gibbins et al. 2010), which in turn increases the likelihood that these situations will turn into a competition/conflict where anger is likely to arise. Even though we analyze a tax audit setting, it is likely that similar conditions might be present in other accounting contexts and therefore inform accounting researchers in general about the potential influence of others' emotions and about the potential merits of avoiding emotions. From an auditor's perspective, our study indicates that showing no emotion can combine the advantages of showing anger (more auditee concessions) and of showing happiness (better relationship) and even protect the auditor from potential disadvantages (decreased compliance) in future periods associated with showing emotions of happiness and anger.

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Tables and Figures

Table 1: Participants' Payoff Structure per Provision and Level (Experiment 1)

Provision 1		Provision 2		Provision 3		Provision 4		Provision 5	
Level	Payoff (in €-cents)	Level	Payoff (in €-cents)	Level	Payoff (in €-cents)	Level	Payoff (in €-cents)	Level	Payoff (in €-cents)
1	0	1	0	1	0	1	0	1	0
2	75	2	30	2	10	2	85	2	50
3	150	3	60	3	20	3	170	3	100
4	225	4	90	4	30	4	255	4	150
5	300	5	120	5	40	5	340	5	200
6	375	6	150	6	50	6	425	6	250
7	450	7	180	7	60	7	510	7	300
8	525	8	210	8	70	8	595	8	350
9	600	9	240	9	80	9	680	9	400
10	675	10	270	10	90	10	765	10	450
11	750	11	300	11	100	11	850	11	500

Notes. This table depicts participants' payoff per provision and level and is expressed in €-cents. The payoff equals the post-audit income. Thus, participants can read their actual payoff in this table without the need for further conversion.

Table 2: Descriptive Statistics of Main Dependent Variable and Control Variables (Experiment 1)

		HAPPINESS (n=28)	*ANGER* (n=28)	*NEUTRAL* (n=30)
CONCESSIONS	Mean	994.29	1,124.29	1,103.33
	SD	168.87	297.14	222.37
EXPECTATION	Mean	1,480.18	1,501.96	1,685.67
	SD	265.69	341.16	459.78
ATT_CLARITY	Mean	6.33	6.46	6.68
	SD	0.93	1.32	0.93
POWER	Mean	4.25	4.61	4.93
	SD	1.46	1.64	2.16
INFO_PROCESS	Mean	6.96	6.89	7.38
	SD	1.45	1.48	1.35
MALE		0.64	0.64	0.70

Notes. This table shows descriptive statistics of our main dependent variable CONCESSIONS and the respective control variables in the three emotion treatments (*HAPPINESS*, *ANGER*, and *NEUTRAL*).

Table 3: Proportion of Participants' Agreement at or Above vs. Below the Midpoint of Pre-Audit Income (Experiment 1)

Treatment	Portion of participants who achieved at least half of pre-audit income	Portion of participants who achieved less than half of pre-audit income
HAPPINESS	0.89	0.11
ANGER	0.61	0.39
NEUTRAL	0.79	0.21

Notes. This table shows the distribution of participants regarding the dependent binary variable SPLIT_IN_THE_MIDDLE in the three emotion treatments (*HAPPINESS*, *ANGER*, and *NEUTRAL*).

Table 4: Multiple Linear and Binary Logistic Regression Results (Experiment 1)

Model	OLS		LOGIT		OLS	
Model#	[1]	[2]	[3]	[4]	[5]	[6]
Dependent variable:	CONCESSIONS		SPLIT_IN_THE_MIDDLE		RELATIONSHIP	
ANGER	130.000*	126.382*	-1.644**	-1.935**	-2.762***	-2.732***
	(67.553)	(63.710)	(0.724)	(0.795)	(0.339)	(0.350)
NEUTRAL	109.048**	154.423***	-0.780	-1.392	-0.727**	-0.840**
	(54.759)	(58.277)	(0.766)	(0.861)	(0.356)	(0.339)
EXPECTATION		-0.220**		0.002**		0.0001
		(0.090)		(0.001)		(0.0004)
ATT_CLARITY		-1.647		0.139		0.027
		(27.611)		(0.269)		(0.145)
POWER		18.391		-0.130		-0.031
		(16.369)		(0.170)		(0.076)
INFO_PROCESS		-28.842*		0.232		0.345***
		(16.641)		(0.206)		(0.128)
MALE		-84.398		0.719		0.287
		(54.422)		(0.612)		(0.339)
CONSTANT	994.286***	1,507.623***	2.079***	-3.17	7.071***	4.292***
	(35.963)	(172.528)	(0.612)	(2.412)	(0.227)	(1.124)
Observations	86	86	83	83	86	86
R-squared	0.055	0.213			0.438	0.527
Adjusted R-squared	0.032	0.143			0.425	0.484
Pseudo R-squared			0.068	0.167		
Prob. > chi-squared			0.044839	0.031871		
Residual Std. Error	239.498 (df = 83)	225.331 (df = 78)			1.333 (df = 83)	1.263 (df = 78)
F Statistic	2.842* (df = 2; 83)	3.534*** (df = 7; 78)			34.39*** (df = 2; 83)	13.28*** (df = 7; 78)
Tests between coefficients of emotion treatments (two-tailed *p*-values):						
ANGER vs. NEUTRAL	0.7672	0.7037	0.1509	0.4033	5.046e-07***	4.853e-06***

Notes. This table displays the results of multiple linear regressions (models [1] and [2]), and models [5] and [6]) and binary logistic regressions (model [3] and [4]) with the dependent variables CONCESSIONS, SPLIT_IN_THE_MIDDLE and RELATIONSHIP, respectively. CONCESSIONS is a metric variable that measures participants' concessions (in €-Cents) as the difference (in €-Cents) between participants' pre-audit income (according to level 11 for all provisions, i.e., 2,500 €-cents) and the post-audit income according to the final levels agreed with the auditor. SPLIT_IN_THE_MIDDLE is a binary variable that equals one if participants conceded half or less of their pre-audit income (i.e., if participants conceded 1,250 €-cents or less in total) and zero otherwise. The relationship to the auditor (RELATIONSHIP) measures the average answer to the following three questions 1. "Did the negotiation build a good foundation for a future relationship with the auditor?" (1="not at all", 9="fully"), 2. "How satisfied are you with your relationship with the auditor as a result of this negotiation?" (1="not at all satisfied", 9="fully satisfied"), and 3. "What kind of 'overall' impression did the auditor make on you?" (1="extremely negative", 9="extremely positive"). ANGER (NEUTRAL) is a binary variable that equals one if a participant was assigned to the Anger (Neutral) treatment and zero otherwise. The reference category is HAPPINESS a binary variable that equals one if a participant was assigned to the Happiness treatment and zero otherwise. EXPECTATION is a metric variable that measures participants' self-reported expected negotiation outcome in €-cents. To determine this amount, participants were asked for each provision separately: "Please use the field 'Expectation' to state the level you actually expect to achieve for each provision." ATT_CLARITY measures participants' self-reported general attention to emotions and how clearly they are able to assign meaning to these emotions as the average answer to the following eight questions: 1. "I pay attention to other people's feelings," 2. "I pay attention to my feelings," 3. "It is difficult for me to describe my feelings," 4. "I am not sure about what other people actually feel," 5. "I think about how other people feel," 6. "I think about how I feel," 7. "It is difficult for me to describe other people's feelings," and 8. "I am not sure about what I actually feel." Possible answers range from 1 ("never") to 9 ("always"). POWER is measured as participants' self-reported answer to the following question: "Who do you think has the strongest position in the upcoming negotiation?" Possible answers range from 1 ("definitely the auditor") to 9 ("definitely myself"). The binary variable MALE takes on the value of 1 if a participant is male. INFO_PROCESS measures participants' information processing motivation as the average answer to the following two questions: 1. "I carefully monitored the behavior of the auditor in the negotiation process" and 2. "I monitored the behavior of the auditor in the negotiation process to modify my own behavior accordingly." Possible answers range from 1 ("does not apply at all") to 9 ("fully applies"). (Robust) Standard errors are shown in parentheses (for OLS models). Asterisks indicate levels of significance as follows: *** p<0.01, ** p<0.05, * p<0.1.

Table 5: Choice Set (Experiment 2)

[1] Level	[2] Probability that the position will be audited	[3] Tax deduction	[4] Payoff without audit	[5] Payoff with audit
15	30%	1,500	1,650	450
14	28%	1,400	1,610	490
13	26%	1,300	1,570	530
12	24%	1,100	1,490	610
11	22%	1,000	1,450	650
10	20%	500	1,250	1,010
9	18%	450	1,230	1,014
8	16%	400	1,210	1,018
7	14%	350	1,190	1,022
6	12%	300	1,170	1,026
5	10%	250	1,150	1,030
4	8%	200	1,130	1,034
3	6%	150	1,110	1,038
2	4%	100	1,090	1,042
1	2%	50	1,070	1,046
0	0%	0	1,050	1,050

Notes. This table displays the decision options of the participants regarding the different tax deductions (level 0 to 15), the financial consequences, and the probability with which a certain deduction level is checked and not accepted by the tax audit.

Table 6: Descriptive Results (Experiment 2)

Panel A: AUDITOR=*SAME*	*HAPPINESS* (n=25)	*ANGER* (n=28)	*NEUTRAL* (n=27)
AGGRESSIVENESS			
Mean	10.96	10.04	9.78
SD	1.81	1.75	2.43
AGGRESSIVENESS_3			
EVASION (frequency)	52.00%	32.14%	25.93%
AVOIDANCE_MAX (frequency)	36.00%	57.14%	37.04%
AVOIDANCE_BELOW (frequency)	12.00%	10.71%	37.04%
Panel B: AUDITOR=*OTHER*	*HAPPINESS* (n=25)	*ANGER* (n=28)	*NEUTRAL* (n=27)
AGGRESSIVENESS			
Mean	10.40	10.39	9.55
SD	1.29	1.50	2.21
AGGRESSIVENESS_3			
EVASION (frequency)	20.00%	32.14%	18.52%
AVOIDANCE_MAX (frequency)	76.00%	60.71%	48.15%
AVOIDANCE_BELOW (frequency)	4.00%	7.14%	33.33%
Panel C: AUDITOR=*NOAUDIT*	*HAPPINESS* (n=25)	*ANGER* (n=28)	*NEUTRAL* (n=27)
AGGRESSIVENESS			
Mean	13.68	13.50	12.30
SD	1.91	2.08	3.33
AGGRESSIVENESS_3			
EVASION (frequency)	88.00%	82.14%	66.67%
AVOIDANCE_MAX (frequency)	12.00%	17.86%	29.63%
AVOIDANCE_BELOW (frequency)	0.00%	0.00%	3.70%
Panel D: Control variables	*HAPPINESS* (n=25)	*ANGER* (n=28)	*NEUTRAL* (n=27)
MALE	0.72	0.75	0.56
MORALE_ILLEGAL	0.32	0.29	0.22
MORALE_LEGAL	0.24	0.25	0.33

Notes. This table shows descriptive results regarding participants' tax aggressiveness (Panel A-C) in the three emotion treatments (HAPPINESS, ANGER, and NEUTRAL) depending on whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated, by another auditor, or would not be audited at all. AGGRESSIVENESS is the level of tax deductions participants chose ranging from 0 (no deductions) to 15 (maximum tax deductions). AGGRESSIVENESS_3 is a categorical variable that equals one (two, three) if participants chose a deduction level that is below the maximum legal amount (is equal to the maximum legal amount, is illegal). Panel D of this table shows descriptive results (proportions) regarding control variables used in further analysis in the three emotion treatments (HAPPINESS, ANGER, and NEUTRAL). The binary variable MALE takes on the value of one if a participant is male and zero otherwise. MORALE_ILLEGAL (MORALE_LEGAL) is a binary variable that equals one if a participant's answer to the following question does not exceed the first quartile: "Please tell me for the following statement whether you think it can always be justified, never be justified, or something in between: 'Cheating on taxes if you have the chance' ('Taking advantage of legal loopholes to save on taxes') and zero otherwise. Possible answers range from 0="never justifiable" to 9="always be justified."

Table 7: Multinomial and Binary Logistic Regression Results (Experiment 2)

AUDITOR=	*SAME*				*OTHER*				*NOAUDIT*	*NOAUDIT*
Model	MLOGIT				MLOGIT				LOGIT	LOGIT
Model#	[1]		[2]		[3]		[4]		[5]	[6]
Variables	AVOID_ MAX	EVASION	AVOID_ MAX	EVASION	AVOID_ MAX	EVASION	AVOID_ MAX	EVASION	EVASION	EVASION
HAPPINESS	1.099	1.823**	1.247	2.085**	2.577**	2.197*	2.522**	2.148	1.299*	2.151**
	(0.803)	(0.808)	(0.918)	(0.991)	(1.114)	(1.229)	(1.198)	(1.312)	(0.739)	(0.940)
ANGER	1.674**	1.455*	1.606*	1.432	1.772**	2.092**	1.600	1.937*	0.833	1.351*
	(0.772)	(0.829)	(0.895)	(0.991)	(0.864)	(0.960)	(0.975)	(1.060)	(0.640)	(0.815)
MALE			1.652**	2.593***			2.330**	2.652**		0.322
			(0.759)	(0.871)			(0.923)	(1.032)		(0.733)
MORALE_ILLEGAL			-1.378*	-1.812**			-0.422	-0.766		-2.640***
			(0.814)	(0.900)			(0.910)	(1.026)		(0.733)
MORALE_LEGAL			-1.328*	-1.651*			-1.205	-0.431		0.515
			(0.777)	(0.878)			(0.860)	(0.942)		(0.817)
Constant	0	-0.357	0.158	-0.838	0.368	-0.588	-0.0913	-1.411	0.693*	1.014
	(0.447)	(0.493)	(0.754)	(0.904)	(0.434)	(0.558)	(0.803)	(0.984)	(0.408)	(0.744)
Observations	80		80		80		80		80	80
Pseudo R-squared	0.0579		0.194		0.0786		0.193		0.0455	0.255
Prob. > chi-squared	0.0450		0.000323		0.0202		0.00147		0.1522	0.000787
Tests between coefficients of emotion treatments (two-tailed *p*-value):										
ANGER vs. HAPPINESS	0.5302	0.6908	0.7225	0.5388	0.5263	0.9376	0.4940	0.8820	0.5544	0.3770

Notes. This table displays the results of multinomial logistic regressions (models [1] to [4]) and binary logistic regressions (model [5] and [6]) according to equation (4) with the dependent variable AGGRESSIVENESS_3 and EVASION, respectively. AGGRESSIVENESS_3 is a categorical variable that equals one (two, three) if participants chose a deduction level that is below the maximum legal amount (is equal to the maximum legal amount, is illegal). EVASION is a binary variable that equals one if participants chose an illegal deduction level and zero otherwise. The categorical variable AUDITOR measures whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated, by another auditor, or would not be audited at all. HAPPINESS (ANGER) is a binary variable that equals one if a participant was assigned to the *Happy* (*Angry*) treatment and zero otherwise. The reference category is NEUTRAL, a binary variable that equals one if a participant was assigned to the *Neutral* treatment and zero otherwise. The binary variable MALE takes on the value of 1 if a participant is male and zero otherwise. MORALE_ILLEGAL (MORALE_LEGAL) is a binary variable that equals one if a participant's answer to the following question does not exceed the first quartile: "Please tell me for the following statement whether you think it can always be justified, never be justified, or something in between: 'Cheating on taxes if you have the chance' ('Taking advantage of legal loopholes to save on taxes') and zero otherwise. Possible answers range from 0="never justifiable" to 9="always be justified." Standard errors are shown in parentheses. Asterisks indicate levels of significance as follows: *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

Table 8: Average Marginal Effects (Experiment 2)

	AUDITOR=*SAME*		**AUDITOR=*OTHER***		**AUDITOR=*NOAUDIT***	
Variables	HAPPINESS	ANGER	HAPPINESS	ANGER	HAPPINESS	ANGER
Pr(AVOIDANCE_BELOW)	-0.155*	-0.157*	-0.190**	-0.133**	--	--
	(0.0831)	(0.0824)	(0.0830)	(0.0678)		
Pr(AVOIDANCE_MAX)	-0.0510	0.136	0.196	0.0394	-0.260**	-0.164*
	(0.132)	(0.126)	(0.125)	(0.120)	(0.103)	(0.0948)
Pr(EVASION)	0.206*	0.0213	-0.00624	0.0941	0.260**	0.164*
	(0.119)	(0.123)	(0.118)	(0.109)	(0.103)	(0.0948)

Notes. The table reports average marginal effects from the regressions in Table 7 (models [2], [4], and [6]). AGGRESSIVENESS_3 is a categorical variable that equals one (two, three) if participants chose a deduction level that is below the maximum legal amount [AVOIDANCE_BELOW] (is equal to the maximum legal amount [AVOIDANCE_MAX], is illegal [EVASION]). EVASION is a binary variable that equals one if participants chose an illegal deduction level and zero otherwise. The categorical variable AUDITOR measures whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated, by another auditor, or would not be audited at all. HAPPINESS (ANGER) is a binary variable that equals one if a participant was assigned to the *Happy* (*Angry*) treatment and zero otherwise. The reference category is NEUTRAL, a binary variable that equals one if a participant was assigned to the *Neutral* treatment and zero otherwise. The variables' standard errors are shown in parentheses. Asterisks indicate levels of significance as follows: *** p<0.01, ** p<0.05, * p<0.1.

Table 9: Effect of the Auditor's Previous Emotion Expressions on Own Emotions and Perceived Interactional Fairness (Experiment 2)

Treatment	OWN_HAPPINESS	OWN_ANGER	FAIRNESS
HAPPINESS	5.84	3.68	6.04
ANGER	4.32	4.46	4.82
NEUTRAL	4.78	4.04	5.89

Notes. This table displays participants' average own emotions and perceived interactional fairness in the three emotion treatments (*HAPPINESS*, *ANGER*, and *NEUTRAL*). OWN_HAPPINESS and OWN_ANGER are the respective answer to the following question about self-felt happiness (anger): "Which emotions do you feel when thinking about the past negotiation?" (1="no happiness (anger)", 9="a lot of happiness (anger)"). Interactional fairness (FAIRNESS) is the average answer to the following three questions 1. "What do you think: how much has the auditor tried to be fair to you?" (1="not at all", 9="very much"), 2. "Would you characterize the negotiation process as fair?" (1="not at all", 9="fully"), and 3. "How much do you believe the auditor wanted to reach a mutually acceptable agreement?" (1= "not at all", 9="very much").

Table 10: Channel Analysis (Experiment 2)

Panel A: AUDITOR=*SAME* (MLOGIT)

Variables	AVOID._MAX	EVASION	AVOID._MAX	EVASION	AVOID._MAX	EVASION
OWN_HAPPINESS	0.331 (0.204)	0.324 (0.215)				
OWN_ANGER			0.156 (0.200)	0.121 (0.214)		
FAIRNESS					-0.104 (0.204)	0.0937 (0.225)
Controls	Y		Y		Y	
Observations	80		80		80	
Pseudo R-squared	0.164		0.181		0.151	
Prob. > chi-squared	0.000556		0.000712		0.00137	

Panel B: AUDITOR=*OTHER* (MLOGIT)

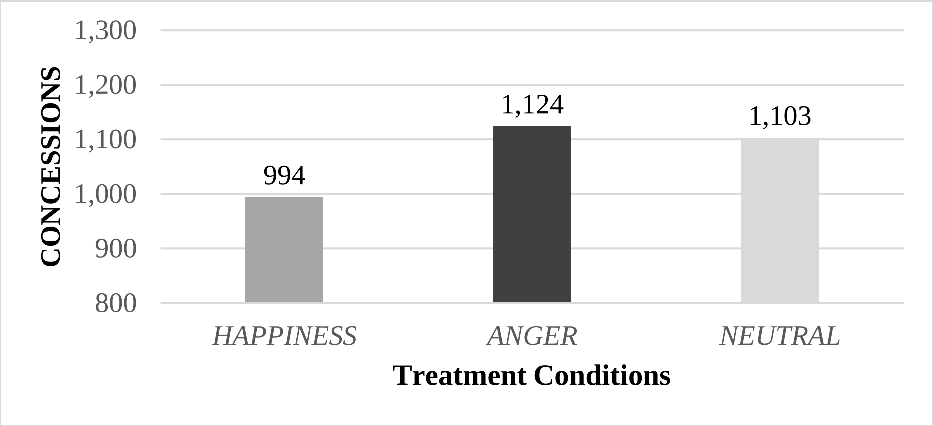
Variables	AVOID._MAX	EVASION	AVOID._MAX	EVASION	AVOID._MAX	EVASION
OWN_HAPPINESS	0.319 (0.219)	0.0799 (0.236)				
OWN_ANGER			-0.224 (0.222)	-0.142 (0.240)		
FAIRNESS					0.168 (0.217)	-0.0837 (0.232)
Controls	Y		Y		Y	
Observations	80		80		80	
Pseudo R-squared	0.164		0.144		0.155	
Prob. > chi-squared	0.00200		0.00624		0.00334	

Panel C: AUDITOR=*NOAUDIT* (LOGIT)

Variables	EVASION	EVASION	EVASION
OWN_HAPPINESS	0.154 (0.161)		
OWN_ANGER		0.091 (0.171)	
FAIRNESS			0.0533 (0.176)
Controls	Y	Y	Y
Observations	80	80	80
Pseudo R-squared	0.185	0.177	0.175
Prob. > chi-squared	0.00413	0.00547	0.00596

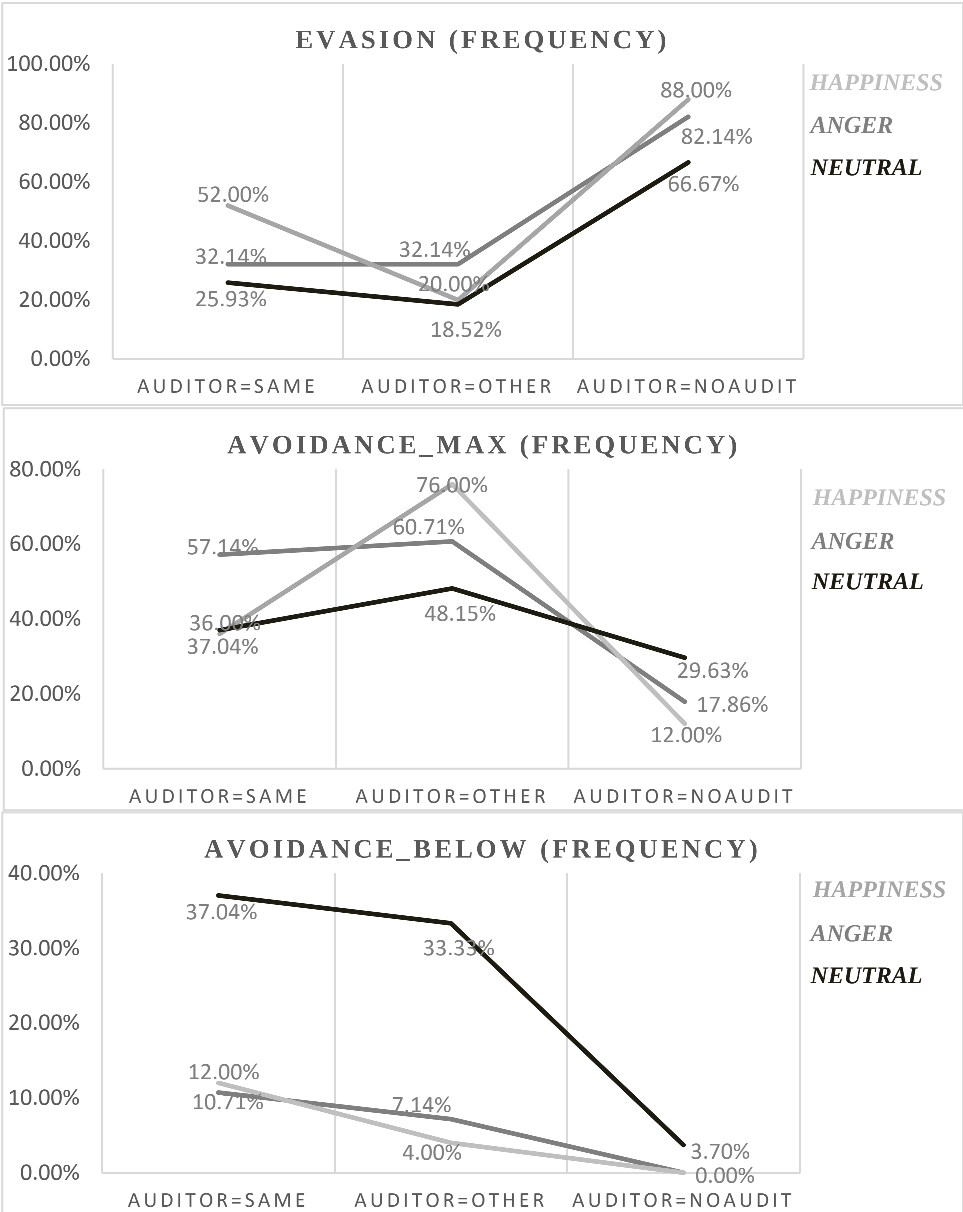
Notes. This table displays the results of multinomial logistic regressions (Panels A and B) and binary logistic regressions (Panel C) similar to equation (4) with the dependent variable AGGRESSIVENESS_3 and EVASION, respectively. In contrast to equation (4), we substitute the treatment variables (*HAPPINESS*, *ANGER*, and *NEUTRAL*) stepwise by OWN_HAPPINESS, OWN_ANGER, and FAIRNESS. OWN_HAPPINESS and OWN_ANGER are the respective answer to the following question about self-felt happiness (anger): "Which emotions do you feel when thinking about the past negotiation?" (1= "no happiness (anger)", 9="a lot of happiness (anger)", respectively. Interactional fairness (FAIRNESS) is the average answer to the following three questions 1. "What do you think: how much has the auditor tried to be fair to you?" (1="not at all", 9="very much"), 2. "Would you characterize the negotiation process as fair?" (1="not at all", 9="fully"), and 3. "How much do you believe the auditor wanted to reach a mutually acceptable agreement?" (1="not at all", 9="very much"). AGGRESSIVENESS_3 is a categorical variable that equals one (two, three) if participants chose a deduction level that is below the maximum legal amount (is equal to the maximum legal amount, is illegal). EVASION is a binary variable that equals one if participants chose an illegal deduction level and zero otherwise. The categorical variable AUDITOR measures whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated, by another auditor, or would not be audited at all. The control variables are the same as in Table 7. Standard errors are shown in parentheses. Asterisks indicate levels of significance as follows: *** p<0.01, ** p<0.05, * p<0.1.

Figure 1: Participants' Mean Concessions (in €-cents) (Experiment 1)



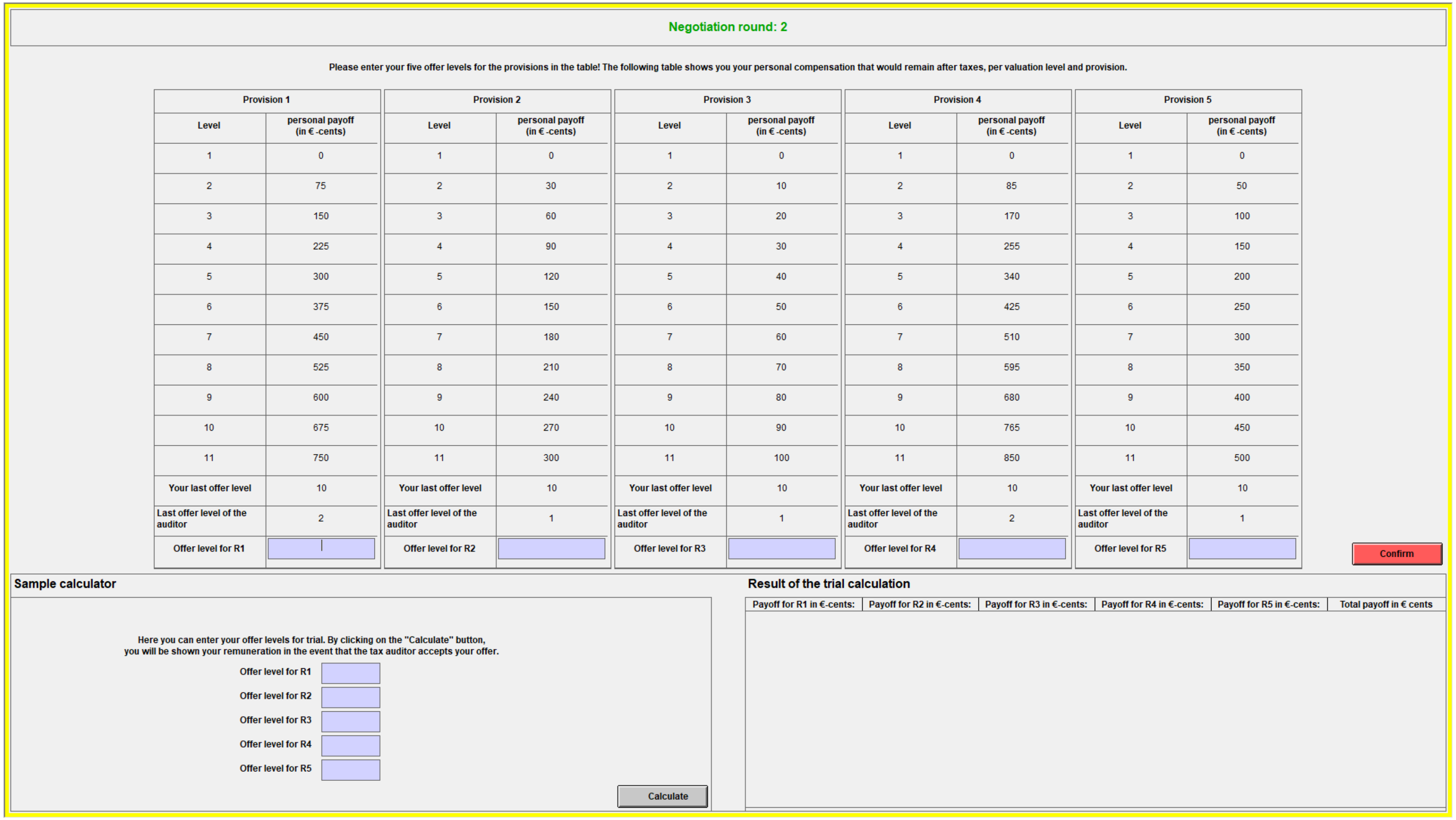
Notes. This figure displays participants' mean concessions to the auditor between the three emotion treatments (*HAPPINESS*, *ANGER,* and *NEUTRAL*).

Figure 2: Descriptive Results (Experiment 2)



Notes. This figure shows the percentage of participants in the three emotion treatments (*HAPPINESS*, *ANGER*, and *NEUTRAL*) that chose a deduction level below the maximum legal amount, equal to the maximum legal amount, or that is illegal depending on whether participants made their decision under the assumption that they were going to be audited by the same auditor with whom they had previously negotiated, by another auditor, or would not be audited at all.

Appendix A – Screenshot of the Mask for Participants to Enter Their Negotiation Offers



Negotiation round: 2

Please enter your five offer levels for the provisions in the table! The following table shows you your personal compensation that would remain after taxes, per valuation level and provision.

Provision 1		Provision 2		Provision 3		Provision 4		Provision 5	
Level	personal payoff (in € -cents)	Level	personal payoff (in € -cents)	Level	personal payoff (in € -cents)	Level	personal payoff (in € -cents)	Level	personal payoff (in € -cents)
1	0	1	0	1	0	1	0	1	0
2	75	2	30	2	10	2	85	2	50
3	150	3	60	3	20	3	170	3	100
4	225	4	90	4	30	4	255	4	150
5	300	5	120	5	40	5	340	5	200
6	375	6	150	6	50	6	425	6	250
7	450	7	180	7	60	7	510	7	300
8	525	8	210	8	70	8	595	8	350
9	600	9	240	9	80	9	680	9	400
10	675	10	270	10	90	10	765	10	450
11	750	11	300	11	100	11	850	11	500
Your last offer level	10	Your last offer level	10	Your last offer level	10	Your last offer level	10	Your last offer level	10
Last offer level of the auditor	2	Last offer level of the auditor	1	Last offer level of the auditor	1	Last offer level of the auditor	2	Last offer level of the auditor	1
Offer level for R1		Offer level for R2		Offer level for R3		Offer level for R4		Offer level for R5	

Confirm

Sample calculator

Here you can enter your offer levels for trial. By clicking on the "Calculate" button,
you will be shown your remuneration in the event that the tax auditor accepts your offer.

Offer level for R1

Offer level for R2

Offer level for R3

Offer level for R4

Offer level for R5

Calculate

Result of the trial calculation

Payoff for R1 in €-cents:	Payoff for R2 in €-cents:	Payoff for R3 in €-cents:	Payoff for R4 in €-cents:	Payoff for R5 in €-cents:	Total payoff in € cents

Note. The text on the screen was translated from another language in which the experiment was conducted.

Appendix B – Negotiation Algorithm

The concession behavior of the algorithm concerning the provisions was constructed as follows. For the provisions that were of low value to the auditor (provisions 1 and 4), the algorithm mirrored exactly the participant's offer on the provisions that were of low value to the participant (provisions 2 and 3). Specifically, the counteroffer on provision 1 was *1 + 11 - the participant's offer on provision 2,* and the counteroffer on provision 4 was *1 + 11 - the participant's offer on provision 3*.

The counteroffers on the provisions that were of high value to the auditor (provisions 2 and 3) depended on the participant's offer on the provisions that were of high value to the participant (provisions 1 and 4): The algorithm made a concession on an auditor's valuable provision that was one step less generous than the concession the participant had made on one of his/her valuable provisions. Specifically, the counteroffer on provision 2 was *11 – the participant's offer on provision 1,* and the counteroffer on provision 3 was *11 – the participant's offer on provision 4*.[64]

For provision 5—the purely distributive item—the counteroffer depended on the concession the participant had made on provision 5. The algorithm made a concession on provision 5 that was one step less generous than the concession the participant had made on this provision. Specifically, the counteroffer on provision 5 was *11 – the participant's offer on provision 5*.[65]

Depending on the participant's offer per provision, the algorithm determined if the overall offer was high enough to be accepted or too low for acceptance. An acceptance of the participant's offer led directly to the end of the negotiation. A rejection, on the other hand, led to a counteroffer by the auditor or the termination of the negotiation by the auditor. At first, the algorithm

[64] With regard to the auditor's counteroffers on his "high-valued" provisions, the algorithm controlled for the case that the counteroffer did not fall below level 1. For example, if a participant offered level 11 on provision 1, the counteroffer on provision 2 would be 11 – 11*(the participant's offer on provision 1)* = 0. In this case, the auditor offered level 1 on provision 2 instead of level 0. The same logic applies for the counteroffer on provision 3.

[65] In this case, the algorithm also checked that no counteroffer fell below level 1 (see also Footnote 64).

checked if the participant's offer exceeded 1,800 €-cents of payoff for the auditor, which represented the implicit goal of the auditor in this negotiation.[66] Furthermore, the algorithm checked if the auditor's next offer would entail a higher payoff for the auditor than the current offer made by the participant. Only when the auditor's next offer would improve the auditor's payoff a counteroffer was made, otherwise the negotiation was either terminated by the auditor if the participant's offer was less than 1,050 €-cents,[67] or accepted by the auditor if the participant's offer guaranteed the auditor a payoff of at least 1,050 €-cents. In the event that the negotiation lasted until the sixth round, the auditor accepted the participant's offer if it guaranteed the auditor a payoff of at least 1,050 €-cents.[68] Otherwise, the auditor terminated the negotiation. In all instances where the auditor terminated the negotiation, the participant was given the opportunity to accept the last auditor's offer. In case participants denied this opportunity, a tax court decided the outcome.

66 To ensure that our algorithm does not drive the negotiation outcomes, we set a high limit for the tax auditor before he accepts a negotiation offer and additionally added uncertainty to the negotiation process as participants did not know when the tax auditor would end the negotiation process and let a tax court decide about the outcome. Hence, this setting does not encourage participants to test out the limits of the tax auditor, because such behavior might backfire drastically by leading to an unfavorable tax court decision. The goal of the auditor (1,800 €-cents) was set by the experimenters and was unknown to the participants of the experiment. This goal value was pretested and represents a sufficiently ambitious threshold.

67 1,050 €-cents (1,250 €-cents minus 200 €-cents for the trial) represent the expected utility of a tax court decision for a risk-neutral individual.

68 The sixth round was the last round of the negotiation and therefore the auditor accepted any offer that would generate at least as much outcome (for the auditor) as the expected value of a tax court decision (1,050 €-cents).

Appendix C – Emotion Statement Manipulations as Presented to Participants

A. Manipulation of Emotion Statements Just Before the Negotiation Started:

HAPPINESS treatment = Text in the box below including the **bold passages**, but not the underlined passages.

ANGER treatment = Text in the box below including the underlined passages, but not the bold passages.

NEUTRAL treatment = Text in the box below without the passages in italics or with underlining.

(Note that the entire text was shown to participants in plain text without any different formatting of the emotion statements; the different formatting is only used here to highlight the differences of the treatment conditions).

"Dear Mr./Ms. Schroeder,
we are meeting again today to discuss the results of the current tax audit. **I am happy about this.** / I am angry about this. I am seeing a particular need for more discussion on your accounting for warranty provisions. We can agree on a joint solution today or have the matter decided by the tax court. **I am glad to be able to look for a solution together with you.** / I am angry about having to look for a solution together with you.
I am now awaiting your first proposal."

Note. Statements were translated from another language in which the experiment was conducted.

B. Manipulation of the Tax Auditor's Emotion Statements During the Negotiation:

Emotion Treatment Condition	Round	Statement
HAPPINESS	1.	"I have received your offer. I am very happy about it!"
	2.	"I have received your offer. I am pleased about it!"
	3.	"I have received your offer. I am pleased about it!"
	4.	"I have received your offer. I am pleased about it!"
	5.	"I have received your offer. It's a pleasure to negotiate with you!"
ANGER	1.	"I have received your offer. You've got to be kidding me!"
	2.	"I have received your offer. I'm very upset about it!"
	3.	"I have received your offer. You've got to be kidding me!"
	4.	"I have received your offer. Negotiating with you gives me nothing but trouble!"
	5.	"I have received your offer. You've got to be kidding me!"
NEUTRAL	1.	"Let me think for a minute."
	2.	"Wait a minute, I'll make you a counteroffer."
	3.	"Wait a minute, I'll make you a counteroffer."
	4.	"I have received your offer."
	5.	"I have received your offer."

Notes. Statements were pretested and translated from another language in which the experiment was conducted. We needed five emotion statements per treatment for the six negotiation rounds to be shown by the algorithm preceding rounds 2 to 6 (for the emotion statements preceding round 1 see part A. of this appendix), but had three different emotion statements per treatment to choose from. Therefore, prior to conducting the experiment, we randomly drew five times from the three different emotion statements of each treatment to determine the statements and their order of appearance to be used by the algorithm preceding rounds 2 to 6 in the respective treatment. The only constraint for this random drawing was that each of the three different emotion statements belonging to the respective emotion treatment was drawn at least once. This order drawn in advance was kept constant across all experimental sessions. Hence, it was identical for all participants in the same emotion treatment condition (single random order).

Appendix D – Effect of Friendliness on Taxes Assessed in Tax Audits

Table D.1: Regression Results

Variables	ADDTAXES
FRIENDLINESS	-0.271** (0.109)
FAMILY	-0.0665 (0.125)
PROF_ACC	0.407* (0.235)
SIZE2	0.309* (0.168)
SIZE3	0.614*** (0.167)
SIZE4	1.473*** (0.224)
SIZE5	1.672*** (0.310)
SIZE6	2.734*** (0.365)
LOSS	0.317* (0.164)
FOREIGN	0.467* (0.238)
CORP_GROUP	0.336*** (0.126)
EVASION	0.646*** (0.141)
IND.SERVICE	-0.152 (0.149)
IND.TRADE	-0.376** (0.156)
IND.CONSTRUCTION	0.0864 (0.169)
KNOWN_FIRM	0.142 (0.135)
EXPERIENCE	0.00987 (0.00966)
SCHOOL	-0.0868 (0.127)
SALARY	0.0685 (0.0417)
TRAINING	0.0106 (0.0361)
MOTIVATION	0.172* (0.103)
SPECIALIZED_AUD	0.314* (0.187)
PRESSURE	-0.370*** (0.132)
HEAD	0.551*** (0.122)
INEFFICIENCY	-0.526*** (0.117)
Constant	8.921*** (0.327)
Observations	572
R-squared	0.612

Notes. The table reports the results of a linear regression. The dependent variable ADDTAXES is the logarithmic additional taxes assessed in the audit. FRIENDLINESS equals one when auditors described the atmosphere as "friendly, cooperative, and constructive" and zero otherwise. FAMILY equals one if at least 50% of the firm is held by one family and zero otherwise. PROF_ACC equals one if the firm is required to publish a profit and loss account and its financial statements are audited by a certified public accountant and zero otherwise. SIZE1 to SIZE6 are indicator variables for the six size categories of the German Tax Audit Regulations in ascending order. LOSS equals one if the firm has suffered financial losses in the audit period and zero otherwise. FOREIGN equals one if the key audit areas include the term "foreign," the firm is a member of a foreign group, or the involved tax auditor is specialized in foreign relations and zero otherwise. CORP_GROUP equals one if the company is a member of a corporate group and zero otherwise. EVASION equals one if the firm is suspected of tax evasion and zero otherwise. For the industry variables SERVICE, TRADE, and CONSTRUCTION, the respective variable equals one if the firm belongs to the industry that corresponds to the variable name and zero otherwise. KNOWN_FIRM equals one if the auditor has audited the firm at least once before and zero otherwise. EXPERIENCE equals the number of years as an auditor. SCHOOL equals one if the auditor has a university degree and zero otherwise. SALARY measures the auditor's wage level. TRAINING equals the number of advanced training courses completed by the auditor per year. MOTIVATION equals one if the tax auditor does not consider the audit objective to be achieved by reaching the de minimis threshold and zero otherwise. SPECIALIZED_AUD equals one if the assistance of a specialized auditor was necessary during the audit and zero otherwise. PRESSURE equals one if the audit was completed in the last quarter of the year and the auditor perceives strong pressure to meet set targets and zero otherwise. HEAD equals one if the head of the audit department participated in the final audit meeting and zero otherwise. INEFFICIENT equals one if the auditor has made assessments in less than 50% of the audit foci defined at the beginning of the audit and zero otherwise. Robust standard errors are shown in parentheses. Asterisks indicate levels of significance as follows: *** p<0.01, ** p<0.05, * p<0.1.