General Information

There are two tasks. Assume that the first is similar to a memory task in which you will read a brief story and then respond to questions about the story at the end of the survey. The second is an audit judgment case. The entire survey should not take longer than 20 minutes.

Let's start with the first task.

Part 1

Instructions:

Please read the following scenario. As you are reading the scenario, try to put yourself in the shoes of the main character and experience the emotions that they are feeling.

You will be asked a couple of memorization questions in Part 3 so please read the text carefully.

NOTE THAT PARTICIPANTS ARE RANDOMLY ASSIGNED TO SEE ONE OF THE TWO MOTIVE PRIMES BELOW.

NOT ACTIVE STATUS MOTIVES (I.E., CONTROL CONDITION):

Imagine that it's Friday afternoon. You've been working hard all week and you've been looking forward to this weekend for quite a while. You and one of your friends have two tickets for a sold-out concert that's happening tonight. Both of you have been looking forward to this show for a long time. In fact, you had to bend over backwards to get the tickets. Your friend has been talking about the concert every day for weeks now, so you know she's excited. And although it's still several hours away, you can already feel your heart beating a little faster than normal.

As you're getting ready for the show at home, your friend calls to tell you that she's coming over in about an hour. Just so you don't forget later, you decide to get the tickets from your drawer. You open your top drawer where you remember leaving them, but they're not there. You search a little deeper in the drawer, but they're not there either.

You stop to take a breath and tell yourself to calm down. You know you put the tickets in a good place, but where? You start searching through your bag. Papers, folders, pens, but no tickets. You turn the bag upside down and shake it. Nothing but junk. Now you start getting worried. What if you lost the tickets? What's your friend going to think?

In a hurry, you look through the laundry. Maybe they're in a pocket somewhere? You find some pieces of paper, but no tickets. You go into your closet and start throwing things to the floor—no tickets. You're feeling upset at this point. Your hands start to shake a little. You think back to when you had the tickets and try to retrace your steps. You clearly remember putting them in your top drawer, so you search again. You inspect everything, but there are no tickets in this drawer. You look through the whole room, but they're nowhere to be found.

You run to the kitchen and start looking on the counters. You open all the cupboards and drawers. You have no idea why the tickets would be there, but you need to look somewhere. In fifteen minutes, your kitchen looks like a disaster area. But still no tickets! You run out into the driveway. Maybe the tickets fell out somewhere? You look in the grass, the bushes, underneath cars. But even if they did fall out, they probably wouldn't even be there by now. As you walk back inside in complete frustration, you feel as though you're ready to pull your hair out. You lost the tickets. And you obviously can't go to the show without them.

Suddenly, you hear a knock on the door. Your friend is early, probably because she's eager to get going. You can hear her humming outside. What are you going to tell her? She'll be crushed. Is there anything you can do? Maybe you should lie? But that probably won't solve anything. As you walk toward the door, you get ready to fess up, take the blame, and hope that everything will be okay. You open the door, ready for the worst.

As you are about to start telling her what happened, she yells "Are you ready?" and pulls out the two tickets from her back pocket. Your eyes get wide. You grab the tickets from her hand and fall to your knees. Your friend has the tickets! She's had them the whole time. You think back

and remember that she wanted to show the tickets to another person, so she took them the other week. You can't believe you forgot. You don't think you've ever felt so relieved in your life. You sit down, shake your head, and put your hand on your chest. You begin to laugh, wiping the sweat from your forehead. You and your friend will get to go to the show after all. Things are going to be just fine.

As you try to forget what happened, you're actually even more thrilled about the concert than before. Your relief turns into elation. You want to shout to everyone just how great you feel. It's as though you just found the winning lottery ticket. You can appreciate going to the concert even more now, knowing that you were very close to not going at all. Your friend is dying to get to the show, and her euphoria is contagious. Both of you run out the door, turn up the stereo, and head off to the most thrilling show of your lives.

ACTIVE STATUS MOTIVES:

Imagine you recently explored the job market. You were offered several jobs and decided to go work for a well-known and powerful company. Besides paying well, this job offers you the greatest chance of moving up—assuming you can prove that you have what it takes.

As you pull into the parking lot on your first day of work, you immediately notice that the lot is full of expensive new cars. Walking to your building, you eye these impressive vehicles and think about the kind of car you should get now, perhaps an upscale luxury sedan or a new sports car. You imagine yourself driving through town in a sparkling new car and you feel yourself becoming more motivated. Entering the lobby, you're impressed by how upscale everything looks—the antique furniture, the artistic decorations, the designer clothing. You're thrilled to be working at such a prestigious company and you feel that this is exactly the kind of job you deserve.

As you wait, another person sits down next to you. A minute later a third person also takes a seat. The two are dressed in brand new business suits, and they're about the same age as you. Each one briefly looks at you, smiles slightly, and says hello. Both of them look a little nervous and you sense that these are probably your new colleagues. Looking at them out of the corner of your eye, you feel both excited and a little anxious. You imagine how much fun it would be to have colleagues with whom you can talk about the new job. But looking at their facial expressions and their body posture, you feel a sense of competition in the air. You realize this job isn't a game.

Your new boss finally comes out and greets everyone. As all three of you walk into the large corner office, everyone sits down. "You're all very fortunate to be here. The company selects only a few people out of hundreds of potential targets each year." Hearing that you beat out so many people to get here sends a rush of pride through your body.

"In the next few months, all three of you will both work both independently and work together. You're going to get to know each other pretty well." As the atmosphere seems to relax a little, you look around the room and everyone smiles.

But the boss continues: "Starting today each one of you will get to work for one of our smaller clients. But we know you joined us to serve our best clients who present intellectually challenging problems for you. We will monitor your work carefully and, after 6 months, one of you will be fired or transferred to another position that you may not find attractive." Hearing this news sends a shiver down your spine. You quickly scan the room. The other two people are trying to suppress any look of concern and show a confident side to the new boss. You remind yourself that you were hired for a good reason and that you deserve a spot at the top. You sit up straighter and put on a confident expression.

"Although one of you will be fired or transferred," the boss goes on, "the person who does the best will not only get a promotion, but they will also become the newest member of our thought leadership group, which is intellectually very rewarding and is a fast track to the top." Pointing to the grand window offices down the hall, the boss finishes: "I see a lot of potential in all of you, but only one of you will make it into one of those big offices. You have 6 months to show everyone what you're made of."

You know there will come a day in 6 months when your boss will again call all three of you into the office. Feeling your heart beating faster, you're anxious and excited. As your boss finishes up

the speech, you're so eager to get started that you can't even pay attention anymore. Your eyes open wide and a rush of adrenaline pumps through your body. You feel like letting out a yell and running out the door to get started. Seeing your two colleagues in the background, you walk out of the office with a rush of anticipation in hopes of achieving something that few people ever have the chance to do…

Professional Audit Judgment Case

Case Information

Note that participants are randomly assigned to see one of the two decision authority conditions below.

LOW DECISION AUTHORITY: When completing this case, suppose that **a colleague who is at your same rank is seeking your advice** regarding a difficult issue on the FY2013 audit of Retail Credit, Incorporated (RCI). RCI is the financing arm of Retail Clothes Land, Incorporated, which is a mid-sized, upscale retail organization. You have previously worked with the partner in charge of the RCI engagement, and the partner has requested that the colleague consult you on this issue. The **partner suggested that your colleague should "pick your brain" on the issue but the colleague is expected to resolve the issue on his own.**

One of the issues involves assessing the reasonableness of a **discount rate** that management uses for valuation purposes. Management prefers relatively lower discount rates because lower discount rates result in larger fair values and gains from securitizations. The details of the securitization transaction are explained on the next page. Read through the following case and evidence.

HIGH DECISION AUTHORITY: When completing this case, suppose that **a colleague who is at your same rank is seeking your advice** regarding a difficult issue on the FY2013 audit of Retail Credit, Incorporated (RCI). RCI is the financing arm of Retail Clothes Land, Incorporated, which is a mid-sized, upscale retail organization. You have previously worked with the partner in charge of the RCI engagement, and the partner has requested that the colleague consult you on this issue. **The partner has directed your colleague to solicit your input and to take and document actions as a result of the advice you provide.**

One of the issues involves assessing the reasonableness of a **discount rate** that management uses for valuation purposes. Management prefers relatively lower discount rates because lower discount rates result in larger fair values and gains from securitizations. The details of the securitization transaction are explained on the next page. Read through the following case and evidence.

Securitization at Retail Credit, Inc. (RCI)

You will assess the discount rate underlying management's fair value estimates for the residual interest in a securitization transaction. Once limited to financial service organizations, securitization of receivables is now common among retailers, manufacturers, and many other kinds of organizations.

RCI is a non-bank organization that securitizes credit card debt on a routine, recurring basis. That is, after pooling similar classes of credit card receivables, RCI sells, for example, the rights to 90% of the underlying cash flows while retaining the rights to 10% of the underlying cash flows (i.e., the retained interest). Importantly, RCI retains the collection risk for 100% of the underlying cash flows. As individual customers default on credit card payments, RCI is in a first-loss position. If losses occur, RCI is first to absorb the loss for the entire credit card receivable. Consequently, if collection problems were to arise, holders of the securitized portion of the credit card receivables would face less risk than would RCI.

Historically, RCI has profited on securitization by investing the proceeds of the securitized portion in financial instruments that earn returns greater than would have been earned from the underlying credit card cash flows alone.

Per GAAP, RCI carries its retained interest at fair value in its financial statements. As this fair value becomes *larger*, RCI records a *larger* "Gain on Securitization" in their financial statements.

The fair value of retained interest, though, is not easy to estimate. Unlike the securitized cash flows, the retained interest portion of cash flows is **not** publicly traded. Valuation of retained interest comes down to a complex, professional judgment process. One of the most important and subjective factors affecting the fair value of retained interest is assessing an appropriate discount rate.

Assessing RCI's Discount Rate

As with other investment assets, the discount rate is **inversely** related to the fair value of retained interest and **positively** related to its risk. For example, poorer quality credit card receivables (e.g., those with poor credit scores and a high risk of non-payment) have greater risks. They require *higher* discount rates, which results in a *lower* estimated fair value of the retained interest on the credit card receivables, and a *lower* gain on securitization.

Conversely, better quality credit card receivables indicate less risk. By assessing *lower* discount rates, both the estimated fair value of retained interest and the gain on securitization will be *higher*.

It is important that you distinguish RCI's credit card securitizations from mortgage securitizations, which are substantially more volatile. RCI does **not** engage in mortgage securitizations.

In general, the two factors that substantially influence the discount rate include:

- **The current risk-free rate.** This risk reflects the cost of borrowing money at no risk and with perfect liquidity. The current rate of the 90-day Treasury is a reasonably good proxy.

- **The risk of default.** This risk reflects potential non-collection of the securitized receivables. The risk of default on the retained interest portion of credit card receivables is influenced by:

    (a) The **credit rating** of the individuals owing money on their credit cards.
    (b) The **terms** upon which credit is extended to customers and the efforts of management to **control** whether credit is extended according to those terms.

(c) The **first-loss position**. Because retained interest is subordinated to the sold portion of the credit cards, it is the first to absorb any losses for the entire underlying receivable. Thus, it generally has a higher discount rate than the securitized portion of the receivable.
(d) The **pre-payment rate** on the underlying individual credit cards.
(e) **Macroeconomic factors** that may affect the probability of individual credit cardholders paying off their balances, such as interest rates and inflation.

RCI relies on multiple benchmarks to determine the most appropriate discount rate. The primary benchmarks are discount rates applied to retained interest by other firms that routinely engage in credit card securitizations. Assume that **Bank of America**, one of the *largest credit card issuers in the world*, and one of the *most stable* managers of credit, applies a weighted average discount rate of **13.5%** to its retained interest (per its most recent 10-K filing with the SEC). General Electric and Chase hold riskier portfolios of credit card debt, and their discount rates are shown in the table below:

	2012	2013	Change
Bank of America	11.5%	13.5%	+ 2.0%
General Electric	14.9%	15.1%	+ 0.2%
Chase	12.0%	18.0%	+ 6.0%
RCI	**11.7%**	**13.2%**	**+ 1.5%**

As shown in the table above, RCI applied a discount rate of 11.7% in FY2012. Your colleague says the following to you: "**Although there are signs of volatility in the market, this is somewhat buffered by the affluent nature of our customer base. Thus, we plan to increase our discount rate to 13.2% for FY 2013.**"

Before continuing, please answer the following. You may look back at prior pages when answering these questions:

1. As the discount rate used to estimate the fair value of RCI's retained interest increases, the estimated fair value

   ☐ increases.
   ☐ decreases.
   ☐ remains the same.

2. As the estimated fair value of RCI's retained interest increases, the gain on securitization

   ☐ increases.
   ☐ decreases.
   ☐ remains the same.

Audit Evidence Obtained thus Far
Regarding the Discount Rate for RCI's Retained Interest

Summary. As explained below, the credit ratings of RCI customers, first loss position, and customers' default rates are each substantially the same as they were last year. But, RCI's policies regarding the extension of credit have changed, as have macro-economic conditions.

Factors that are substantially the same as last year:

The credit ratings (FICO scores) of RCI's customers. In an initial interview with RCI management, they noted, "Compared to the largest organizations that mass market credit cards to customers, our customer base is relatively affluent. Our parent company is an upscale retailer. The credit scores of our customers are relatively good." After some initial audit test work, you've learned that the customers whose credit card receivables make up RCI's retained interest have credit scores as follows on the table, below. You've confirmed that they do indicate good credit scores, overall. These credit ratings are current as of RCI's last inquiry with the credit bureaus, which, for each cardholder, is usually when the credit card was originally issued:

Credit FICO score[1]	Credit rating	Percentage of Receivables
599 and Below	Very Poor	6.1%
600 – 619	Poor	17.5%
620 – 659	Moderate	25.8%
660 – 699	Good	34.9%
700 and above	Very Good	15.7%
Total		**100.0**%

First-loss position. RCI's first-loss position has not changed from prior years.

Default rates. The default rate on RCI's credit cards has not changed substantially from prior years.

Factors that have changed since last year:

RCI's extension of credit. A review of RCI's underwriting manual shows that their control policies for credit card issuance and maintenance reflect best practices. However, RCI recently began increasing the extent to which it has extended credit on generous terms (no-interest-for-18-months and higher credit limits). Management says this change was made to attract more customers and boost revenue per customer. Frequently, these credit terms have been extended to existing credit cardholders without re-checking their credit (since first issuing their credit cards). RCI management maintains that new credit checks would have been costly and would have unnecessarily inconvenienced their affluent customers, which would threaten their loyalty.

Macroeconomic factors. The economy is currently recovering from a recession, which has restricted the supply and demand of commercial and consumer credit in many (but not all) markets.

Unemployment remains high and many of the jobs lost during the recent economic downturn have been high paying jobs, such as investment banking and analyst positions. As a result, the credit scores of many of RCI's cardholders may have worsened considerably since RCI originally issued credit cards to these customers. Since RCI is not rechecking their customers' credit before extending them new credit, it is possible that are unaware of worsening collectability risk. To conclude that it is reasonable for RCI's or

[1]FICO scores are a widely accepted measure of the likelihood that credit users will pay their bills.

Nordstrom's discount rate to be better than the rates used by Bank of America or the broader retail industry, we may need to gather audit evidence about RCI's customers' **current** creditworthiness.

While RCI's customers are more affluent than Chase's customers on average, high-end retail chains have suffered more than low-cost retailers during this economic downturn. Saks and Nordstrom have reported foot traffic slowdown on same store comparisons while deep-discount stores like Wal-Mart have fared better.

Part III: Case Questions

Please answer the following questions. You may look back at prior pages. Your colleague has assessed a **discount rate of 13.2% for 2013** and has asked for your recommendation. The impact of discount rate adjustments could end up being material for quantitative or qualitative reasons (i.e., if the change enabled RCI to beat forecasts, etc.).

1. Please recommend the most reasonable discount rate to use in estimating the fair value of RCI's retained interest. (Recall that lower discount rates result in higher valuations of retained interest and higher gains on securitization.)

   My assessment: _____%

2. How **confident** are you in your assessment of the discount rate? Assume your response to this question will not be visible to your colleague.

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|----|----|----|----|----|----|----|----|----|----|
0    1    2    3    4    5    6    7    8    9    10
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Not at all confident — **Very confident**

3. What **range** of discount rates would you recommend to the colleague as acceptable for RCI to use, while maintaining sufficiently high financial reporting quality?

   between _____% and _____%.

4. Provide a brief explanation of your recommendation.

5. How **accountable** do you feel for your recommendation?

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|----|----|----|----|----|----|----|----|----|----|
0    1    2    3    4    5    6    7    8    9    10
```

Not at all accountable — **Very accountable**

6. How **competent** is the colleague who asked you for advice?

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|----|----|----|----|----|----|----|----|----|----|
0    1    2    3    4    5    6    7    8    9    10
```

Not at all competent — **Very competent**

7. To what extent do you expect your colleague to **carefully consider your advice**?

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|----|----|----|----|----|----|----|----|----|----|
0    1    2    3    4    5    6    7    8    9    10
```

Not at all — **Very much**

8. To what extent do you believe the colleague should **consult the engagement manager** on this issue?

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|----|----|----|----|----|----|----|----|----|----|
0    1    2    3    4    5    6    7    8    9    10
```

Not at all — **Very much**

General Questions

Regarding the story that you read in part 1…

1. Where did the story take place?

   - ☐ In an office building
   - ☐ In a house / apartment
   - ☐ In a bus station
   - ☐ None of the above

2. Which of the following appeared in the story?

   - ☐ A panhandler
   - ☐ A boss
   - ☐ A friend
   - ☐ None of the above

3. How many co-workers appeared in the story?

   - ☐ None
   - ☐ One
   - ☐ Two

After reading the story, to what extent did you feel…

competitive?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

enthusiastic?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

excited?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

frustrated?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

angry?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

nervous?

1---------2---------3---------4---------5---------6---------7---------8---------9
Not **Very**
at all **Much**

Please indicate your current rank (check one):

- ☐ Partner
- ☐ Senior Manager
- ☐ Manager
- ☐ Senior
- ☐ Staff
- ☐ Intern

In which service area do you work?

- ☐ Audit
- ☐ Tax
- ☐ Advisory
- ☐ Other: _____

What is your gender?

- ☐ Female
- ☐ Male

What areas of industry expertise do you have? _____

What areas of auditing or accounting expertise do you? _____

How long have you worked as a professional accountant?

_____ years and _____ months

The following statements concern your personal reactions to a number of different situations and are meant to be answered about you in general. No two statements are exactly alike, so consider each statement carefully before answering. If a statement if TRUE or MOSTLY TRUE as applied to you, circle T. If a statement is FALSE or NOT USUALLY TRUE as applied to you, circle F.

1. I find it hard to imitate the behavior of other people. T F
2. My behavior is usually an expression of my true inner feelings, attitudes, and beliefs. T F
3. At parties and social gatherings, I do not attempt to do or say things that others will like. T F
4. I can only argue for things that I already believe in. T F
5. I can make impromptu speeches - even on topics about which I have almost no information. T F
6. I guess I put on a show to impress or entertain people. T F
7. When I am uncertain how to act in a social situation, I look to the behavior of others for cues. T F
8. I would probably make a good actor. T F
9. I rarely need the advice of my friends to choose movies, books, or music. T F
10. I sometimes appear to others to be experiencing deeper emotions than I actually am. T F
11. I laugh more when I watch a comedy with others than when alone. T F
12. In a group of people I am rarely the center of attention. T F
13. In different situations with different people, I often act like very different persons. T F
14. I am not particularly good at making other people like me. T F
15. Even if I am not enjoying myself, I often pretend to be having a good time T F
16. I'm not always the person I appear to be. T F
17. I would not change my opinions in order to please someone else or win their favor. T F
18. I have considered being an entertainer. T F
19. In order to get along and be liked, I tend to be what people expect me to be rather than anyone else. T F
20. I have never been good at games like charades or improvisational acting. T F
21. I have trouble changing my behavior to suit different people and different situations. T F
22. At a party I let others keep the jokes and stories going. T F
23. I feel a bit awkward in company. T F
24. I can look anyone in the eye and tell a lie with a straight face - if for a good cause. T F
25. I may deceive people by being friendly when I really dislike them. T F