TRUSTING/DISTRUSTING AUDITORS' OPINION

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Abstract

Trust relations are important for effective interchanges between auditors (trustees) and market participants (trustors) such as investors, creditors, customers, and other users of financial statement information. In particular, auditors' opinion regarding client's ability to continue in existence is essential to improving social capital in Society. Previous literature has shown that the issuance of a qualified audit report with doubts about the viability of a company may have imminent consequences for both auditors and financial statement users. We build on previous research by analyzing auditors' trustworthy behavior regarding this important opinion in a Throughput Model. A number of propositions are forwarded regarding how investors and other users may trust (distrust) auditors' opinions. In this regard, dominant determinants of six trust positions were used to explain the auditors', and in turn investors' and creditors' decision-making process.

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INTRODUCTION

The main question posed in this paper inquires: Are financial information users' decisions influenced by their trust on auditors' opinion? Given the apparent relationship between auditors and stakeholders (such as creditors, investors, unions, regulators, interest groups) it is important to understand how trust can nurture or erode social capital when parties interact. Social capital is "features of social organization, such as trust, norms, and networks, that can improve the efficiency of society by facilitating coordinated action" (Putnam, 1993: 167). Further, Coleman articulated that (1988: 98) "like other forms of capital and human capital, social capital is not completely fungible but may be specific to certain activities. A given form of social capital that is valuable in facilitating certain actions may be useless or even harmful for others."

Hence, distrust may emerge when the suspicion arises that auditors are not facilitating their roles as objective information providers (Lewicki, McAllister, & Bies, 1998). Further, if society believes that the auditor function is of little or no value than trust can be disrupted, that is no trust, without producing distrust (Parkhe & Miller, 2000). In this paper we share Lewicki et al. (1998)'s view that trust and distrust are not the opposite end of a single trust-distrust continuum (Flores and Solomon, 1998). In addition, we believe that the very complexity of the trustworthiness on auditors' function relies on simultaneous high levels of trust-distrust relations (Lewicki et al., 1998). Therefore this paper highlights how different pathways can augment trust (distrust) as dominant as well as indicate auxiliary pathways that are not as dominant but can have a simultaneous impact on decisions. This approach implements a Throughput Model (Rodgers, 1997) that highlights six dominant pathways to a decision, while emphasizing decision makers' assessment of a situation.

The main purpose of the auditing profession is to enhance social capital by honoring public trust, which primary function is to attest the truth and correctness of financial statements (Duska & Duska, 2003). In other words, in honoring public trust auditors should protect third parties interests rather than evaluate the consequences of their opinions on their relationship with the client. From this perspective, the Throughput Model (Rodgers, 1997) is utilized to illustrate how different trust positions are aligned with a particular decision-making pathway in order to enhance, trust, distrust or no trust. This particular model is employed in this paper in that it illustrates: (1) six dominant cognitive process pathways to a decision, (2) a relationship between individuals' processes and trust positions, and (3) what other pathways may need to be improved in order to modify individuals' decisions.

Trust is viewed in this paper as a (1) set of beliefs or expectations, and (2) willingness to act on those beliefs (Doney, Cannon, & Mullen, 1998). These beliefs or expectations have grown up due to often long-lived relationships, intense in nature when there may be a great depth to the relationships between the parties, or where there are frequent interactions between them; the parties may also be reciprocally interdependent, and bounded whether by law or contract, such that the parties have incentives to maintain their relationship (Kleinman & Palmon, 2000).

Although, a few recent papers provide a general view of trust and reputation of different parties (Dellarocas, 2003; Sabater & Sierra, 2005; Scott & Walsham, 2005), we are unaware of any such link between auditors and society. Given the demise of one of the largest international accounting firms, Arthur Andersen, and to its misappropriate way of examining Enron's financial records, global attention is now focused on auditors' trust and reputation positions. In this paper, we explore auditors' opinions regarding the ability of their clients to continue in existence, which are perhaps the most complex and controversial decisions for this profession (Abbot, Parker, & Peters, 2003). Such opinions, called “the going concern evaluation”, is extremely important for financial users because the issuance of a warning signal in the auditor report regarding the future of the company may affect investors and other third parties’ decisions (i.e., re-allocation of credit). However, we explain how auditors face trust dilemmas and potential economic and non-economic incentives influencing their decisions (i.e., the fear to be dismissed, the self- fulfilling prophecy, etc.).

To illustrate this phenomenon we discuss six dominant trust positions taken from Kramer (1999), which is aimed to reduce uncertainty and simplifying complexity by providing specific assumptions about auditors’ decision-making pathways. In this regard, the analysis of dominant determinants of six trust positions (a rational choice, rule-based trust, category-based trust, third parties as conduits of trust, role-based trust, and history-based trust/ dispositional-based trust) highlight how different trust perspectives may be used to describe auditors’ trustworthiness.

This paper focuses on a single concept of trust and that these six positions are merely different antecedents to it based on different decision-making pathways. The importance of distinguishing between the different positions relates to what is contained in each of the six dominant pathways. Thus, in this paper these determinants of trust positions can emerge as a substitution of uncertainty in longer chains of coordinated psychological relationships among auditors and users of financial statements. The prerequisite/thought or basis is that trust can have the effect of reducing costs thereby improving successful relationships (Creed & Miles, 1996; Cummings & Bromiley, 1996; Dore, 1987).

The next section deals with trust definitions, followed by a section devoted to explain the institutional trust nature between auditors and financial statement users such as stockbrokers, investors, creditors, and society. This section is followed by how the decision-making model, The Throughput Model, is related to the dominant determinants of six trust positions. Then, the case of the author's opinion about the going concern evaluation and the six trust decision pathways are discussed. Lastly, conclusions and implications are drawn from this research.

DEFINITION OF TRUST AND TRUSTWORTHINESS

Trust affects auditors' positions within networks by influencing investment and credit decisions, while distrust can lead to disadvantages such as auditors' clients not receiving financing in a timely manner, hence going out of business (Sparrowe, Liden, Wayne, & Kramer, 2001). Also, Gambetta (1988) emphasized that uncertainty can lead to distrust and less cooperation. Others (e.g., Kramer, 1999) have indicated that the level of trust in a relationship affects the degree of defensiveness. That is, stakeholders, relying on auditors' viewpoint, can have difficulty in concentrating on messages, motives, and values of organizations and therefore will find these less accurate, whereby an increased distortion of messages may result. Therefore understanding trust and distrust relationships are required for effective problem solving in organized capital markets worldwide (Ryan & Buchholtz, 2001). When financial statement users rely on auditors' opinions they recognize their common interests and cooperative relations may take place (Axelrod, 1984).

The three basic trust conceptions of incentive (encapsulated interest), normative, or psychological based are cognitive. That is, these concepts entail that trust depends on assessments of the trustworthiness of another in a particular situation (Hardin, 2002;

Rodgers, 2007). Therefore, trustworthiness can be for rational reasons of one's interest, for normative reasons, or for reasons of character or psychological disposition. Trustworthiness can be viewed as the underlying base that promotes for an efficient solution to problems of coordinating expectations and interactions between individual actors (Kim, Ferrin, Cooper, & Dirks, 2004; Luhmann, 1979). In fact, society has carved out a vital trust position for independent auditors, which is absolutely essential for the effective functioning of financial markets (Duska, 2005; Kramer, 1999). In this way, an auditor's opinion pertaining to an organization's ability to continue in existence is an act to establish trust with stockbrokers, creditors, investors, and society. That is, individuals need to know whether an organization is in danger of failure. The easiest way to get this critical information is to examine an auditor's opinion regarding a company's ability to continue in existence (Barnes, 2004). However, if individuals are uncertain about the auditor's opinion, they might as well refrain from trusting, and seek other informational sources. Uncertainty appears to be an unavoidable feature of trust, which individuals constantly attempt to find good reasons for believing that the uncertainty they are prepared to accept, is low (Dirks & Ferrin, 2002). The irony of this relationship is that an organization (client) hires the auditor to report to third parties whether the client is truthfully revealing the outcomes and status of its operations (Kleinman & Palmon, 2000, p. 39).

In the next section, the Throughput Model and its relation with dominant determinants of six trust positions is discussed. We then provide a discussion integrating auditors' opinion underlined by six trust decision pathways, before we present the conclusions and implications from this paper.

THE THROUGHPUT CONCEPTUAL MODEL

Since Rodgers (1997) developed the Throughput Model, it has been applied successfully to different economic and social settings such as loan analysis (Rodgers, 1992, 1999), managerial ethical decisions (Rodgers & Gago, 2001, 2004), auditors' decision with environmental risk information (Rodgers & Housel, 2004) and sexual harassment (Culbertson & Rodgers, 1997).

To clarify several critical pathways, the Throughput Model separates the decision-making process into its four main stages (see Figure 1): perception (**P**), information (**I**), judgment (**J**) and decision choice (**D**). In this model perception and information are interdependent because information can influence how the decision-maker frames a problem (perception) or how he/she select the evidence (information) to be used in the decision-making process.

Insert Figure 1 about here

The first processing stage (perception in Figure 1) involves the ***framing*** of an organization's environment (**P**). This means perceiving deviations (risk perceptions) from auditing sources in the organization's books. It also includes other internal and external informational factors that could affect auditors' area of responsibility. The double-ended arrow connecting perception and information in Figure 1 represents this relationship. For example, the auditor's review of such items as marketing plans, financial accounting and non-financial reports associated with the internal operations should be highly significant to auditors' perception of their responsibility.

An organization's information (**I**) as portrayed by auditors' viewpoint can influence trust relations. Wicks, Berman, and Jones (1999) argued that trust lowers agency and transaction costs, promotes smooth and efficient market exchanges, and improves organizations' ability to adapt to complexity and change (1999: 99). For example, John Morrissey, deputy chief accountant of the Securities and Exchange Commission stated that inside the United States, the Business Roundtable and several large and prominent U.S. registrants cited the strength of the U.S. capital markets and the importance of high quality information in preserving investor confidence (Morrissey, 2001: 2). Also, he emphasized that the enhanced rules of the Ethics Committee of the International Federation of Accountants "… are based on the need to maintain investors' confidence and trust in the reported numbers, through the services of an auditor that will be perceived as objective and unbiased."

In the judgment stage (**J**), financial and non-financial information are analyzed and weights are placed on key information items in order to compare alternatives or the criteria across the alternatives. This enables the auditor, for example, during the decision-choice stage to make or to refuse an "opinion". Auditors employ investigatory and analytical precepts to diagnose the cause of the problem. Both deductive and inductive reasoning are required for effective diagnosis, and direct data gathering as shown by the direct arrow leading from information to judgment in Figure 1 above. This stage also includes the development of alternative solutions or courses of action. Auditors can retrieve from their knowledge bases for ideas and suggestions; examine concepts and pertinent accounting information; and employ ingenuity and creativity. The appraisal of alternatives may be based upon a single criterion or methodology, or a combination of objective criteria or methodologies such as compensatory or non-compensatory weighting schemes (Rodgers, 1992, 2006).

The trust decision (**D**) is based on positive expectations of/or confidence in the trustworthiness of another party. Currall and Epstein (2003: 194) stated "Therefore, trust arises from judgments we make about the likelihood that another party will behave in a trustworthy manner as well as assessments we make about the possible costs we will suffer if the other party turns out to be untrustworthy."

The model proposed here is used to conceptualize the dominant determinants of the six trust positions related to the above six decision-making pathways in understanding trust behavior (Rodgers & Gago, 2001). The six trust positions introduced in the previous section are: trust as a (1) rational choice, (2) rule-based trust, (3) category-based trust, (4) third parties as conduits of trust, (5) role-based trust, and (6) history-based trust/dispositional-based trust. These six pathways are viewed as the most dominant and influential determinants for decision-making ruled by the six trust positions. Although, it is important to note that other possible pathways in the Throughput Model also may contribute to the above trust positions, but not as significantly as the dominant pathway. These dominant positions enhance or weaken social capital based on the situation or contextual framework (Figure 2).

Insert Figure 2 about here

$$\mathbf{P \rightarrow D} \qquad \mathbf{(1)}$$

$$\mathbf{P \rightarrow J \rightarrow D} \qquad \mathbf{(2)}$$

$$\mathbf{I \rightarrow J \rightarrow D} \qquad \mathbf{(3)}$$

$$\mathbf{I \rightarrow P \rightarrow D} \qquad \mathbf{(4)}$$

$$\mathbf{P \rightarrow I \rightarrow J \rightarrow D} \qquad \mathbf{(5)}$$

$$\mathbf{I \rightarrow P \rightarrow J \rightarrow D} \qquad \mathbf{(6)}$$

(1) **P → D** represents the shortest pathway, that is to say the quickest way for achieving a goal: individuals perceive and decide on. Since perception and information are interdependent, individuals' framing of the problem is constantly updated. *Trust as a rational choice* implies that individuals are always motivated to act in their perceived self-interest (Adam Smith's doctrine: the good man or woman should act for his or her short-term self gain, but that those individual actions would lead, through the invisible hand of market forces, toward an ultimate net benefit for society [Hosmer, 1995: 395]). Decisions about trust are assumed to be similar to other forms of risky choice in that individuals are presumed to be motivated to make rational and efficient choices thereby improving social capital between auditors and society. That is, in accordance to traditional economic models individuals are assumed to act to maximize expected gains or minimize expected losses from their transactions. This perspective includes two central elements (Hardin, 1991). First, the knowledge that enables an individual to trust another is considered. Second, it relates to the incentives of the individual who is trusted to honor that trust. This type of trust is based on a complete understanding with the other party's desires and intentions. Therefore, this type of trust allows one to act as an "agent" for the other and substitute the other in interpersonal transactions (Whitener, Brodt, Korsgaard, & Werner, 1998). Hardin (1991: 189) stated "You can more confidently trust me if you know that my interest will induce me to live up to your expectations. Your trust then encapsulates my interests."

Investors are typically more interested in assessing the information under which the auditors reviews and whether this maximizes the alignment of auditors' performance and the investors' financial returns. If we are convinced that information focuses auditors on maximizing our economic benefit we are more likely to trust (distrust) them. This leads to the first proposition:

> P_1 *Auditors' opinions on an organization's information are trustworthy (untrustworthy) to the extent that they (do not) protect/maximize third parties interests*.

(2) **P** $\rightarrow$ **J** $\rightarrow$ **D** depicts *rule-based trust* and emphasizes the rules or laws used by individuals. That is, rules depend on the structure of the decision as well as the interpersonal behavior of the implementers of the decision. The structural and interpersonal components of rules are likely to influence perceived trust (Brockner & Siegel, 1996) and increase or decrease social capital. Hummels and Roosendaal (2001) asserted that one way to deal with trust is to draw up an extensive contract that specifies the rights and obligations of the contract partners and to decide on the penalties when one of the parties fails to meet the obligations. **P** $\rightarrow$ **J** $\rightarrow$ **D** implies that direct information influence from **I** is disregarded or downplayed, as above, and a trust decision is reached via judgment. There are at least several reasons for this occurrence. Information may be disregarded due to its unreliability. An individual forms a perception with small or no weights on information, weights the possible outcomes before making any judgment and then concludes with a trust decision.

Currall and Epstein articulated that (2003: 196) "Because it involves such personal consequences, trust is a largely solitary decision. Yet under certain conditions, our decision to trust also may be influenced by what family or friends do or urge us to do. Indeed, it is common for us to be swayed to trust someone by what others tell us about him or her." Referring to Kant's Groundwork for the Metaphysics of Morals (Kant, 1964: 1), his universal law and the first formulation of the Categorical Imperative states that "if it was right for one person to take a given action then it must be right for all others to be encouraged to take that same action." Currall and Epstein also stated that "Furthermore, although trust is an evidentiary decision, we may use family members' or friends' experience as a proxy for our own. And, because trust decisions are often made in the context of incomplete information, we may seek out the advice of others as a supplement to our own information" (p. 196). Individuals maintain a set of values that are either implicitly or explicitly understood. In addition, philosophers, religious and non-profit organizations have emphasized and promoted ideal sets of ethical principle or rules (Rodgers and Gago, 2001). Examples of accepted sets of ethical principles or rules at the implementation stage include laws and regulations, spiritual doctrine, codes of trust for specialized and licensed groups such as auditors, and a code of conduct within different organizations. This leads to the second proposition:

> P_2 *Society's perception that auditors' follow a higher (lower) level of standards (rules) than other market participants will result in a higher (lower) reliance on an organization's information*.

(3) **I** $\rightarrow$ **J** $\rightarrow$ **D** reflects that *category-based trust* is predicated on norms of obligation and cooperation rooted in social similarity. Category-based trust may be extended broadly within the social capital in society and may be reinforced by ritual and symbolic behaviors (Dore, 1987) that emphasize common group membership and familiarity (Good, 1988). Competitive or cooperative interdependence that exists between two groups influences individuals' beliefs about group members' trust and the affect associated with them. However, cooperation can exist without trust (Mayer, Davis, & Schoorman, 1995). Trust can also be viewed as a means of promoting cooperation when other methods may not work or be as efficient. Common characteristics within a group

may provide an impetus to trust and may provide a positive, self-reinforcing process of interaction. People are more willing to assign positive characteristics relating to honesty, cooperativeness, and trust to individuals within a particular group (Brewer, 1996). However, common characteristics not found could provide an untrusting atmosphere when confronted with a dilemma (e.g., the prisoners' dilemma game; Hardin, 1991). A game such as "prisoner dilemma" can be implemented in order to discover how cooperation between unrelated parties can develop by normal choice. For example, this type of game, each participant can either "cooperate" (invest in a common good) or "not cooperate" (exploit the other's investment). Institutional form may acquire legitimacy based on perceptions about the trust of its representing authorities. Powell and Dimaggio (1991) added that an institution is considered legitimate to the extent that its structure and procedures follow the dictates of prevailing rules and beliefs. This leads to the third proposition:

P_3 *More (fewer) market transactions occur when society believes that a trustworthy (distrustworthy) auditing profession was responsible for reporting habits of organizations.*

(4) **I** $\rightarrow$ **P** $\rightarrow$ **D** highlights the *third parties as conduits of trust* and assumes that decision-makers use themselves or the people around them as their basis for defining ethical standards in lawless settings thereby impacting on social capital. Third-party information serves to reinforce existing relations, making one's perception more certain of his trust (or distrust) in another. Further, Labianca, Brass, and Gray's (1998) study showed that third parties can be drawn into negative interpersonal interactions. Therefore, trust depends on the direct connection between two individuals versus their indirect connections through third parties and the conditions in which the strong indirect

connections that enhance trust reverse their effect to create distrust. The certainty may also be an illusion of whether or not the individual or the institution is trustworthy or not. Further, Blau (1964: 112-113) advocates that trust develops because social exchange involves unspecified obligations for which no binding contract can be written. Hence, trust is committed to an exchange without one knowing how the other person will reciprocate. This leads to the fourth proposition:

> P_4 *Bad (good) publicity of an organization will influence auditors to issue a negative (positive) opinion of their view of an organization's reporting its information.*

(5) **P → I → J → D** underscores that *role-based trust* is tied to formal societal structures, depending on individual or institution-specific social capital attributes. This pathway implies that an individual's perceptions or framing of the problem will influence the selection and type of information to be employed in judgment. That is, an individual is motivated to act appropriately (perception), which influences the information set used to be analyzed (judgment) before a trust decision is made. This perspective suggests that a morally bound individual with good motivations is more likely to understand what task should be performed than a morally lacking individual would do. Beauchamp and Bowie (1997: 39) advocated, "A person who simply follows rules of obligation and who otherwise exhibits no special moral character may not be trustworthy." Simon (1947: 125) advanced that the willingness to accept an authority's decisions can occur through courtesy to the authorities' organizational role and can be made "independently of judgments of the correctness or acceptability of the premise (of their decisions)." Further, Tyler and Degoey (1996) claimed that individuals' evaluations of organizational authority trust shaped their willingness to accept the decisions of authorities as well as

influencing feelings of obligation to follow organizational rules and laws. In addition, Fisher, Gunz, and McCutheon (2001) advocated that individuals are bound together by professional roles within society. The special trust relationship between society and its professions can reduce or eliminate harm or exacerbate problems that people are confronted with on a daily basis. This leads to proposition five:

P_5 *Stakeholders are more (less) trusting when they view auditors as the guardians (agents of the organization) of reliable and relevant information for their decision-making purposes*.

(6) **I → P → J → D** represents the *history-based trust* and/or *dispositional trust* that arises either through the personal experience of recurring exchanges. Such social capital as gathering previous years credit payment history on an organization, or ascertaining its ability to obtain a lower interest rate based on its reputation.

The historical-based/dispositional trust position takes into account the probability of others likely actions based on past and present information. For instance, contracts are inherently incomplete – all the contingencies in a transaction simply cannot be specified. In a long-term relationship, reciprocity is at the heart of this process. Through this process, business transactions become part of the social context where psychological factors intertwine with economic considerations in arriving at a decision (Bradach & Eccles, 1989). In sum, the security and stability of recurring reciprocal exchanges enable learning (Hedelin & Allwood, 2001) and engender trust (Powell, 1990). This perspective represents the last possible fragmented way for individuals' decision-making based on information processing. In this sequence, an individual studies the given information (**I**), frames the problem (**P**), and then proceeds to analyze the problem (**J**) before rendering a decision (**D**) leading to some level of trust or distrust. This leads to the sixth and final proposition:

P_6 *Auditors' trustworthiness (distrustworthiness) is a function of how independent information can (cannot) influence their opinions regarding an organizations' performance.*

In the next Section of our paper we applied this framework and its six major trust/distrust positions in discussion of auditors' behavior. We illustrate these positions with several examples in Table1.

THE CASE OF THE AUDITORS' GOING CONCERN OPINION AND SIX TRUST PATHWAYS

From a normative point of view, auditors should maintain an independent (trustworthiness) position in their decision making process. Investors' reaction to the issuance of a qualified audit report (i.e., a warning signal) for a client with strong financial distress could be based on the *trust as a rational choice* pathway, **P** → **D**. This pathway implies that information (**I**) is regarded and the decision is made without a significant judgment (**J**). In trusting as a rational choice, investors and others stakeholders are motivated to act in their self-interest to make efficient and rational decisions. That is, investors just trust auditor's opinion and then will decide to move (or not) their investment to other companies. In this regard, investors perceive that a qualified audit opinion (**P**) reflects a rational risk to keep their investment on the company. Thus, without looking for further information or making any evaluation of the company's ability to survive, investors would trust auditors' opinions moving their investment to other market opportunities (**D**).

Insert Table 1 about here

In this process, investors and stakeholders see auditors as an expert “agent” who contributes to minimize expected losses or maximize expected gains in their transactions (Kornish & Levine, 2004). Similarity, potential consumers that trust auditor’s warning signal would decline to buy products of financially distressed companies (Ruiz-Barbadillo, Gómez-Aguilar, Fuentes-Barbera, & García Benau, 2004). Other important trustors of the auditor’s report are commercial bankers. To improve their financial health, companies may try to get a loan from a bank institution. In this negotiation process, loan officers tend to reject requests for credit when auditors have disclosed concerns in their reports (Guiral-Contreras, Gonzalo-Angulo & Rodgers, 2007).

However, the reality is that the auditing market is highly competitive (Duska & Duska, 2003) and auditors might face economic incentives to avoid the release of warning signals. Several research papers have shown that the number of qualified audit report for firms with bad financial health is scarce. For example, Ruiz-Barbadillo et al. (2004) and DeFond, Raghunandan, and Subramanyam (2002) concluded that only a 4 percent of financially distressed companies receive a warning signal from auditors. That is, even the purpose of auditing is to honor and protect public interests, economic incentives, such as audit and non audit fees, may affect auditors’ independence (Reiter & Williams, 2004). Auditors may be motivated to act in their perceived self-interest, in order to maintain future quasi-rents specific to a given client relationship (DeAngelo, 1981). Audit fees, and client size have been some of the indicators used by the empirical research to measure the association between clean audit reports and economic incentives (Vanstraelen, 2002). For example, investors, such as bankers and financial analysts, may rationally distrust a clean audit report when they perceive that the company has been attested for a long time by the same auditing firm (i.e., long term contracts). Another example to distrust auditors' opinion is the so called "opinion shopping," that is, when the company' management fires the auditor after the receipt of a warning signal about its ability to survive and hires a new one who issues a clean audit report (Krishnan, 1994; Krishnan & Stephens, 1995). Thus, investors and other users perceiving an opinion shopping would distrust clean auditors' opinions regarding firms that are financially distressed. Following this argument, financial statement users will distrust if they perceive that auditors are not protecting their interests when issuing clean reports for financially distressed firms. In this situation, *distrust as a rational choice* pathway, **P → D,** may explain investors and other third parties' behavior.

The *rule-based trust,* **P → J → D,** highlights auditors' trust relations, whereby they issue their opinion based upon prescribed rules. Lewicki et al. (1998) assert that *rule-based trust* (deterrence-based) arises from the notion that you trust someone due to a very strict normative rule or legal system is in force. *Rule-based trust*, both formal and informal, depicts much of what the auditors' explicit and tacit understandings with other individuals. It is based on auditors and other parties shared understandings regarding the system of rules regarding appropriate behavior. For example, auditors draw up a contract (**P**) based on the rules, that determine if the company abides by the rules (**J**), and decide (**D**) on whether to issue an opinion. From the *rule-based trust* pathway, investors may have confidence in auditors, a self-correcting profession which has reacted after the Enron and other financial scandals. For example, after the Enron-Arthur Andersen scandal the American Institute of Certified Public Accountants (AICPA) has significantly updated its code of ethics. In addition, recent reforms has being implemented as a result of the Sarbanes-Oxley Act of 2002 to increase auditor independence, including mandatory audit firm rotation and the banning of most auditor-provide non-audit services.

However, some authors have argued that compliance with externally imposed rules may not be construed as one is trustworthy (Sitkin & Roth, 1993; Nakayachi & Watabe, 2005). This argument is also supported by the so-called "strategy issue cycling" theory recently developed by Moore, Tetlock, Tanlu, & Bazerman (2006) and Bazerman, Moore, Tetlock, & Tanlu (2006). These authors assert that current accounting reforms, rather than contribute to overcome conflicts of interests faced by auditors, seem to hide the resistance of the auditing profession to leave the current system. Thus, more regulation, such as the Sarbanes-Oxley Act, may be interpreted as a set of temporary and illusory solutions to an unresolved problem. Here, the *rule-based distrust,* $\mathbf{P} \rightarrow \mathbf{J} \rightarrow \mathbf{D}$**,** may help understand why investors distrust auditors' opinions within a strong legal system which is more "apparent" than real (Bazerman et al., 2006; Moore et al., 2006).

The *category-based trust* pathway, $\mathbf{I} \rightarrow \mathbf{J} \rightarrow \mathbf{D}$**,** may explain why investors show a tendency to highly trust international auditing firms. In this regard, big audit firms are seen as specialist in many sectors (i.e., banking, insurance, high-technology). That is, international audit firms might be categorized as more trustworthiness in comparison to national and regional firms, having strong incentives to protect their reputation in the global market (O'Clock & Devine, 1995; Jensen, 2006). In addition, firms with higher international reputation have the ability to hire and retain the best professionals (Greenwood, Prakash, & Deephouse, 2005). Following this argument, investors would trend to attribute positive characteristics to international firms such as independence, reputation, industry knowledge, etc. For instance, an unqualified audit opinion for a financially distressed company issued by a small audit firm would provoke a feeling of distrust. On the other hand, the *category-based trust* pathway would explain investors' trust on the same unqualified opinion guarantee by a select few large audit firms.

Auditors may be sensitive to *third parties as conduits of trust* (e.g., newspapers report on litigation), $\mathbf{I} \rightarrow \mathbf{P} \rightarrow \mathbf{D}$**,** and hence the issuance of an auditor's opinion may alter trust relations with others (e.g., bankers, bond holders, etc.). For instance, a qualified audit report may provoke credit rating agencies lower their recommendation (e.g., from "investment grade" to "junk"). Some studies have examined whether auditors are more likely to issue positive opinions when the client has been subject of negative press coverage prior to the date of the audit opinion. The conclusions of Joe (2003) and Frost (1991) indicate that negative events in the press influenced auditors' perception of a client's bankruptcy probability, increasing auditors' propensity to release early warning signals. Thus, third parties information (i.e., financial press, financial analysts, credit rating agencies) (**I**) might serve to reinforce investors' trustworthiness (**P**) and auditor's opinion would be trusted/distrusted (**D**). Further, *third parties as conduits of distrust* pathway is also useful to illustrate why Arthur Andersen lost its reputation and consequently, most of its clients after the intensive press coverage of the Enron's scandal, where that auditing firm never issued a warning signal about company's ability to continue in existence.

From the *role-based trust* point of view $\mathbf{P} \rightarrow \mathbf{I} \rightarrow \mathbf{J} \rightarrow \mathbf{D}$, auditor' decision to avoid the release of a warning signal might be seen as a trustworthy behavior if the auditor takes into account the environment conditions that affects client's ability to survive. In deciding to issue a qualified audit report, auditors face the so called "self-fulfilling prophecy effect", that is, a market belief that the issuance of a warning signal will precipitate client's failure due to its negative impact on creditors, investors, suppliers and customers who would lose their confidence on the company (Citron & Taffler, 2001). For instance, the issuance of a qualified audit report has been found to cause clients' stock price declines (Jones, 1996) and reduce a loan officer's willingness to grant a loan (Guiral-Contreras et al., 2007). Then, the auditor's decision of avoiding the release of a warning signal (**I**) could be trusted (**D**) whether the investors believe there is still chance for the company to recover its financial health (**J**) and perceive that the release of a warning signal will unnecessary hasten users' confidence on the client (**P**).

However, under the *role-based distrust* pathway the issuance of a warning signal could lead investors to distrust auditors. In recent years, some accounting auditing firms have issued going-concern opinions for companies that eventually went bankrupt. As a result, most of the financial press has asked why auditors did not warn investors. This situation has provoked a new high risk-litigation environment in which investors and other stakeholders' now have a higher tendency to sue auditors (Frost, 1994). Following this argument, the possibility of being sued by their clients or third parties would lead auditors to perceive that the potential costs of issuing a warning signal are higher than issuing a clean audit opinion (i.e., loss of audit fees, the self-fulfilling prophecy effect, etc). Thus, in spite of the economic effects that may cause a negative opinion on the client's financial statements, auditors' behavior may be primarily based on the negative consequences of lawsuits and bad reputation in its audit market position, deciding to act in its own benefit with the issuance of a warning signal.

Finally, the *history-based trust* and/or *dispositional trust* pathway, $\mathbf{I} \rightarrow \mathbf{P} \rightarrow \mathbf{J} \rightarrow \mathbf{D}$, represents auditors' trust relations given a sufficient amount of information. In this pathway information dominates the perception in an "open-minded" auditor who will offer a willingness to listen to distinct and previously unacknowledged perspectives. For example, the consideration of the feasibility of management's plans can be a key factor in the decision of whether to issue an opinion (Abbott et al., 2003). In addition, the *history-based distrust* argument might explain why auditors' psychological disposition may lead investors to distrust auditors' role as vanguards. Moral seduction theory suggests that the structural features of the close auditor-client relationship may cause auditors' involuntary lack of independence. Thus, even the most open-minded and diligent of auditors may be unconsciously biased when processing information (Bazerman et al., 2006; Moore et al., 2006).

CONCLUSIONS AND IMPLICATIONS

A vast variety of social capital devices, including institutions, norms, and so forth, enable individuals/organizations to cooperate in an efficient and effective manner. The Throughput Model can be useful in understanding what causes auditors to act in a manner that seems not to exploit social capital for positive results. Social capital augmented in a positive manner is 'good' for society according to the ethical principles of normative philosophy, not according to the moral standards of a given group or culture. Beliefs about what is right, just and fair are possible influences on social capital.

The Throughput Model can provide more insight on auditors' and other professionals' deliberations when they are confronted with the task on being the guardian of public trust. That is, the model posits six dominant decision pathways that can influence knowledge transfer from client and auditor informants effective enough to establish their trustworthiness (Szulanski, Cappetta, & Jensen, 2004). Further, this paper can serve an educational purpose (Koehn, 2005), providing an alternative framework to examine auditors' reporting decisions.

Future research can study if a particular trust position supported by a particular decision-making pathway is more appropriate given a particular situation involving "trust." In addition, future research can explore which decision-making pathway can typify better relationships between organizations; their auditors and investors' trust positions; ultimately the improvement of social capital for society at large. Finally, the model different pathways can allow us to better understand how trust is nurtured and eroded as different parties interact.

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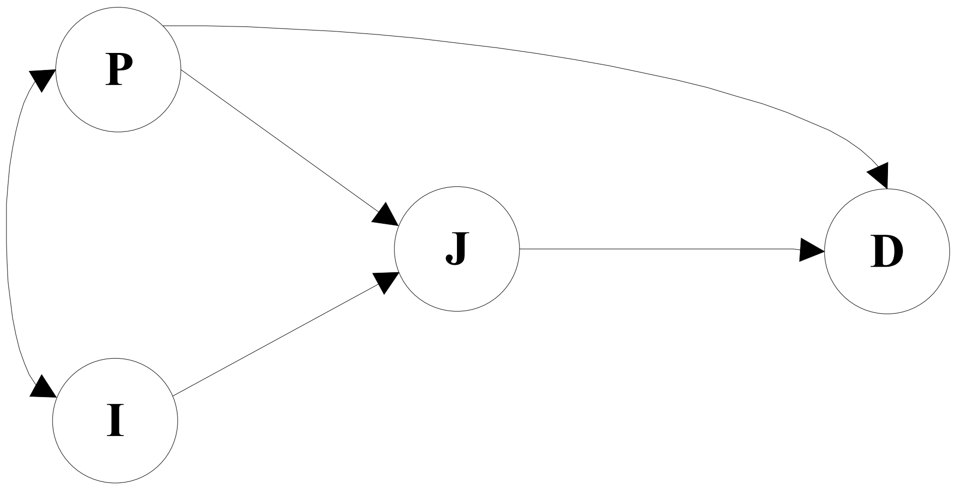
FIGURE 1

Social Capital Cognitive Processes Diagram



Where P= perception, I= information, J= judgment, and D= decision choice.

FIGURE 2

Trust positions & Social capital

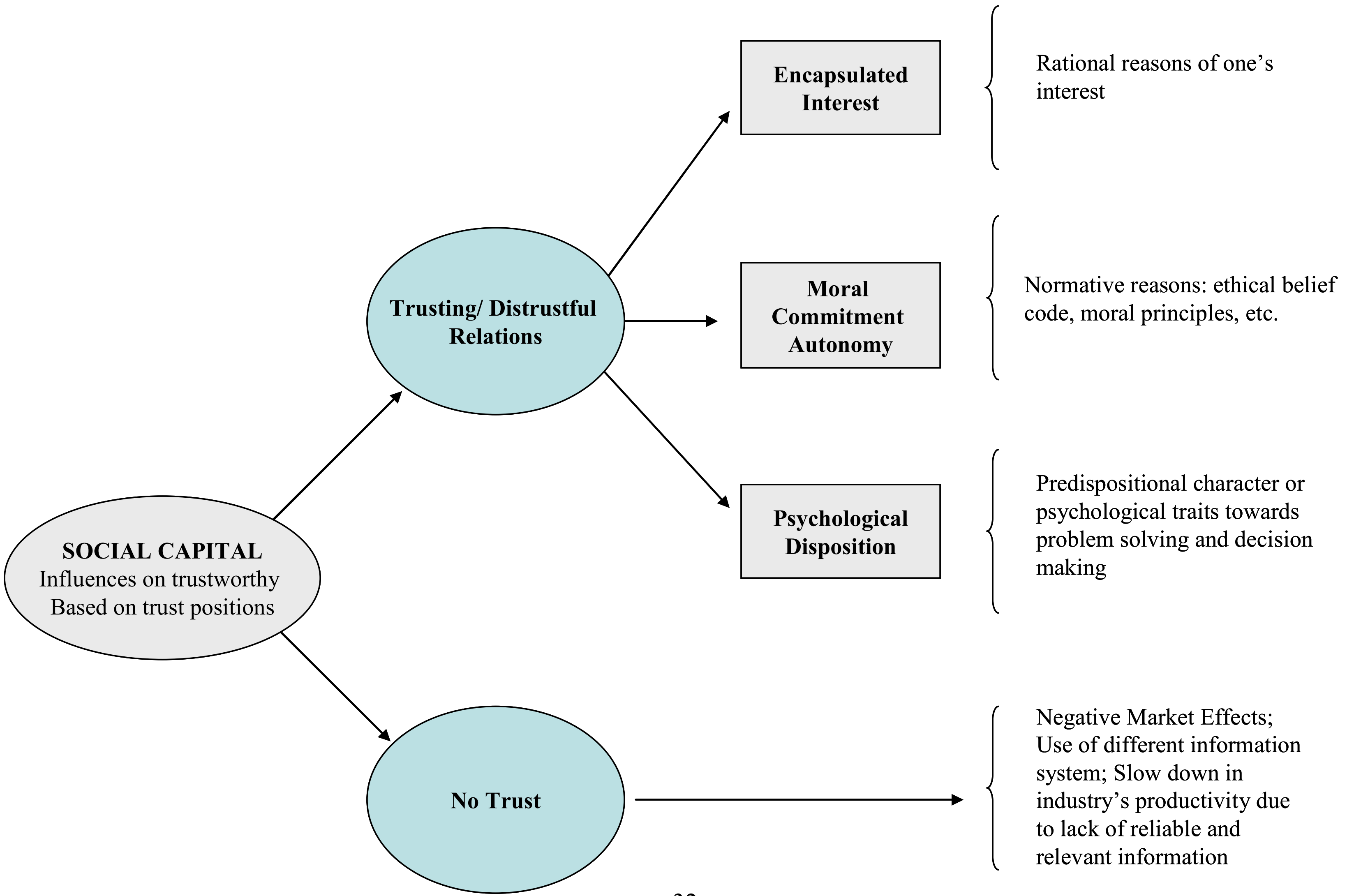


TABLE 1
Simultaneous Trust/Distrust Positions on Auditors' function

Position	Trustworthiness level	Definition	Examples
As a rational choice **(P $\rightarrow$ D)**	**Trust**	Investors and stakeholders see auditors as expert "agents" contributing to minimize expected losses or maximize expected gains in their transactions, whereby the release of a warning signal is interpreted as protecting investors and stakeholders' interests	- Loan officers tend to reject requests for credit when auditors have disclosed concerns in their reports. - Stockholders move their investment to other companies after the issuance of a warning signal. - Potential consumers that trust auditors may decline to buy products of companies receiving warning signals. - Suppliers may fear that the client will not be able to pay after the issuance of a warning signal by auditors.

	Distrust	Investors and stakeholders may perceive auditors having strong economic incentives to avoid the release of a warning signal. Thus, they distrust auditors' clean opinions on the ability of their clients to continue in existence	- The larger the client, the smaller chance of receiving a going concern opinion. - Auditors are less likely to modify the opinion for new clients and for those that have been clients for a long period of time (e.g., Arthur Andersen was auditing Enron for about sixteen years, KPMG was Xerox's auditor for approximately 40 years, etc.). - Given the current highly competitive auditing market, recent loss of audit clients appears to significantly moderate the willingness of auditor to disclose a going concern opinion. - Only few financially distressed companies receive a warning signal from their auditors.
Rule-based **(P → J → D)**	**Trust**	Investors and other stakeholders may see the auditing profession as ethically exemplar due to a very strict normative rule or legal system function in force. In addition, the auditing profession may be viewed as a self-correcting profession which has positively reacted after the Enron-Arthur Andersen episode and other recent financial scandals	- The American Institute of Certified Public Accountants (AICPA) has significantly updated its code of ethics. - The Sarbanes-Oxley Act of 2002 may have the potential ability to reduce auditors' incentives and clients' pressures to bias reporting by increasing auditor independence, including mandatory audit firm rotation and the prohibition of providing non-audit services.
	Distrust	Investors and other stakeholders perceive that the weak current legal system leads them to highly distrust auditors' opinions (i.e., strategy issue cycling theory)	- Contrary to the *rule-based trust* position, the Sarbanes Oxley Act may be viewed as a set of inefficient rules and laws. - The AICPA updates its code of ethics just to maintain its status quo against public interest after resounding financial scandals.

***Category-based* (I → J → D)**	**Trust**	Investors and other stakeholders highly trust auditors' opinions from international accounting firms	- In terms of a superior reputation, international auditing firms are viewed as high-status companies that convey more legitimacy than small audit firms. - High-status audit firms are considered as specialist in many sectors, such as banking, insurance and high technology. - International auditing firms have a superior ability to recruit, retain and motivate the very best professionals.
	Distrust	Investors and other stakeholders have a tendency to highly distrust auditors' opinions from small auditing firms	- Small audit firms have more economic incentives to be dependent on their clients. - Non-international accounting firms do not possess the enough expertise to release on-time warning signals regarding their client's risk of bankruptcy.
***Third parties as conduits of trust* (I → P → D)**	**Trust**	Investors and other stakeholders highly trust auditors' opinions when media reports support their clients' financial (either healthy or distressed) status	- Negative events in the press influence auditors' perception of a client's bankruptcy probability, increasing auditors' propensity to release a warning signal to investors. - Credit rating agencies scores affects auditors' understanding of their clients' financial status.
	Distrust	Investors and stakeholders highly distrust on auditors involved in financial scandals and corruption cases	- The Arthur Andersen dramatic collapse after the media coverage pertaining to the Enron financial scandal, which at the time was one of the world's top accounting firms. - PricewaterhouseCoopers paid $175 million in 1998 as a result of a lawsuit due to its misappropriate way of examining Bank of Credit and Commerce International (BCCI)'s financial records.

Role-based **(P → I → J → D)**	**Trust**	Investors and stakeholders may perceive auditors' decision to release a clean audit opinion for a financially distressed client might be seen as a trustworthy behavior if the auditor takes into account the environment conditions that affects client's ability to survive	- There is a market believe that suggests that the issuance of a warning signal directly contributes to provoke the final bankruptcy of an already distressed client (i.e., the so-called "self-fulfilling prophecy effect"). For instance, many commercial banks reject firms' request for financing when those firms have received a warning signal from their auditors. - Auditors' fear to cause damage to their clients' shareholders. Several research reports indicate that the release of a warning signal significantly reduce clients' stock price.
	Distrust	Investors and stakeholders may perceive auditors' decision to release a warning signal (clean opinion) for a financially distressed client might be seen as an untrustworthy behavior under a high (low) risk exposure auditing environment	- In the light of the recent financial scandals, auditors fear they will loose their market reputation when involved in. Thus, investors may perceive that auditing firms, rather than improve their compliance with externally imposed rules (e.g., Sarbanes Oxley Act), have increased the tendency to release warning signals in order to protect their market reputation. - Many auditing firms use their audit report containing a warning signal as a shield for potential lawsuits. - In auditing environments characterized by a low litigation risk, such as the cases of Spain, Belgium and Hong Kong, auditors may offer a high reluctance to alert investors.

History-based and/or dispositional **(I → P → J → D)**	**Trust**	Investors and stakeholders may trust a clean audit opinion (warning signal) for a financially distressed client might be seen as a trustworthy behavior if they perceive that available information dominates auditors' decision	- Auditors' expert knowledge and their privileged access to non-public information place them in the best position to make a judgment about the ability of the client to continue in existence. - After examining the financial information of a distressed client, the auditor must evaluate both management's plans (i.e., forecasts, budgets) and abilities to conclude the firm's risk of bankruptcy
	Distrust	Investors and stakeholders may perceive a clean audit opinion for a financially distressed client might be seen as an untrustworthy behavior if they perceive that auditors' decision since may be unconsciously biased when processing independent information (e.g., moral seduction theory)	- *Selective perception bias* refers to auditors' involuntary tendency to reach their own self-interest even when they try to be independent. Thus, in order to maintain expected audit fees, auditors may be unintentionally reluctant to issue warning signals. - *Discounting of information bias* refers to people tendency to be only aware of immediate consequences of their course of action. This bias may lead auditors to unintentionally perceive potential reputation losses and lawsuits costs as distant and uncertain, favoring the issuance of clean audit reports.