

The Use of Remedial Tactics in Negligence Litigation

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ABSTRACT: Prior research suggests that negative outcomes affect judge and juror judgments of auditor actions, contrary to the intent of the legal system. We experimentally examine whether remedial tactics (apology and first-person justification) cause lower frequencies of negligence verdicts against an auditor in a civil litigation case. Our results indicate that apology and justification individually result in lower frequencies of negligence verdicts when compared to a control group receiving no remedial tactic. We also find that the use of both tactics together does not provide incremental benefit over either one of the tactics individually. Additionally, we present evidence that remedial tactics result in lower assessments of auditors' responsibility to detect fraud. While prior research finds that remedial tactics mitigate the assessment of blame by directly-injured parties, our results expand theory by providing evidence that remedial tactics also impact the decisions of unharmed observers.

Keywords: auditor negligence, litigation, apology, justification, remedial tactics

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1. Introduction

Legal standards indicate that auditors' work should be evaluated based on the quality of the auditors' actions and not on the consequences of the audit. However, prior research has established that outcome effects influence judges (Anderson, Jennings, Lowe and Reckers 1997) and jurors (Lowe and Reckers 1994) when evaluating auditor actions, thereby distorting the intent of the legal system. As legal expenses continue to increase for public accounting firms (Melnitzer 2007), auditors remain justifiably concerned with unfavorable legal verdicts. Knowledge of outcomes can negatively bias judgments against auditors in negligence cases by increasing jurors' need to assign blame (Kadous 2001) and causing jurors to ignore legally relevant considerations such as audit quality (Kadous 2000).

We investigate two remedial tactics that may result in lower frequencies of negligence verdicts against auditors: apology and first-person justification. Remedial tactics help disassociate the actions of the accused with negative outcomes (Blumstein et al. 1974). Apologies allow the accused wrongdoer to express sorrow, penitence, or regret about a situation without admitting guilt (Taft 2000; Tanick and Ayling 1996). Alternatively, a first-person justification allows the accused to indicate the appropriateness of decisions given the information available when decisions were made (Schlenker 1980).

We examine the effects of remedial tactics using an experiment where jury-eligible participants read a transcript and rendered a verdict in an auditor negligence trial adapted from Kadous (2001). Our study provides evidence that jurors who receive an auditor's

apology or first-person justification provide significantly lower frequencies of negligence verdicts compared to jurors not receiving remedial tactics.

Our findings suggest that an apology results in lower levels of jurors' need to assign blame to the auditor, and a first-person justification alters jurors' expectations of the auditor's professional responsibilities when each tactic is compared to a group receiving no remedial tactic. We find no added benefit to the use of these remedial tactics together compared to either tactic individually. Additionally, we explore the influence of remedial tactics on jurors' perceptions of the auditor's responsibility to detect fraud. We find that the effects of remedial tactics on negligence verdicts is mediated by perceptions of the auditor's responsibility to detect management fraud, an interesting finding in light of auditors' concerns regarding an expectation gap between their actual and perceived roles.

Research in psychology, management, and medicine concludes that remedial tactics are effective when expressed directly to injured parties. Our research extends prior findings by examining the effects remedial tactics have on unharmed jurors who cannot directly forgive the accused. We provide evidence that remedial tactics are also effective when expressed to an unharmed, third-party observer. Our findings suggest that utilizing remedial tactics can cause more favorable jury verdicts in an auditor civil litigation trial.

The remainder of this paper is organized as follows. The second section presents background, theory, and hypotheses. The third section describes the experimental design

and procedures. The fourth section provides the results and discussion. The final section contains concluding comments and limitations.

2. Background, Theory Development, and Hypotheses

Civil litigation expenses against business professionals have increased significantly as plaintiffs and their attorneys seek remuneration for alleged professional negligence. Legal expenses for public accounting firms increased from 7.7 percent of revenue in 1999 to 14.2 percent in 2004 (Melnitzer 2007). Accountants remain justifiably concerned over the audit “expectation gap” and increased costs associated with defending audit decisions.

Knowledge of outcomes affects individuals’ judgments (Fischhoff 1975), influences management decisions (Brown and Solomon 1993; Jamal 1993) contributes to increased verdicts against auditors (Anderson et al. 1997; Lowe and Reckers 1994), and leads to reverse outcome bias in certain circumstances (Peecher and Piercey 2008; Lipe 2008). Jurors often over-rely on outcome information when evaluating auditors’ performance (Kadous 2000; Kadous 2001; Lowe and Reckers 1994) even though outcomes represent imperfect information regarding the appropriateness of a decision (Tan and Lipe 1997). Plaintiffs’ attorneys may introduce negative outcomes (i.e., significant economic loss to shareholders, employee and community job losses, and company economic downturn) into trial testimony in an attempt to link outcomes with auditor actions. As a result, negative outcomes can overshadow other pertinent factual and contextual information leading to increased judgments against the auditor. We examine, in an auditor litigation setting, the impact of two remedial tactics (apology and first-person justification) found to cause a reduction in legal liability claims in other contexts.

Remedial Tactics

Remedial tactics are specific verbal responses to incidents with negative outcomes (Goffman 1961; Goffman 1967) that individuals use to influence impressions of prior actions. Individuals accused of breaking a social norm utilize these tactics when an offended party demands sanctions (Scott and Lyman 1968). Prior research has identified two remedial tactics individuals can use to remedy a perceived social violation: apologies and accounts. We examine whether an apology and a specific type of account (first-person justification) cause fewer negligence verdicts against auditors in litigation cases.¹ Remedial tactics do not alter the facts surrounding an encounter; rather, they diminish the impact of negative outcomes on judgments made in hindsight. When effective, remedial tactics change evaluators' judgments to more positive assessments by disassociating the actions of the accused with negative outcomes (Blumstein et al. 1974).

Physicians and other healthcare providers faced with potential malpractice lawsuits experience significantly fewer legal claims when they employ remedial tactics (Berwick 2003; Lamb 2004; Wu and Pronovost 2003; Zimmerman 2004). Interestingly, evidence from medical malpractice suggests monetary settlements often fail to satisfy individuals because the injured parties desire an apology to provide emotional healing (Leape 2006; Schmidt 2007). The use of remedial tactics in medicine differs in three important ways from their use in auditor litigation. First, in a medical malpractice situation, the physician (the offending party) directly approaches the patient or close family member (the damaged party) and delivers the remedial tactic. In an auditor litigation setting, the

auditor expresses remedial tactics in testimony directed toward the juror (an uninjured third-party observer). Second, in a medical malpractice setting, the damage caused by the offending party typically involves physical injury or death, while alleged auditor negligence is linked to economic damages. Third, the observed reduction in medical malpractice claims occurs before a negligence trial. In auditor negligence litigation, remedial tactics cannot be employed until a lawsuit is filed and the auditor utilizes the tactics during formal trial proceedings. Because of these differences, we examine whether the effects found in medical malpractice also exist in an auditor litigation context.

Apology. Plaintiffs alleging negligence seek to associate negative outcomes with auditor actions, which leads to an increase in jurors' need to assign blame to the auditor for the outcomes (Kadous 2001). Such an association results in more verdicts against auditors despite their performance of the audit in accordance with professional standards. An apology is an expression of sorrow, penitence, or regret about a situation given without admitting wrongdoing (Taft 2000; Tanick and Ayling 1996). Apologies facilitate emotional or psychological healing in victims of wrongdoing (Taft 2000; Weiner 1986, 1995). Prior research has found that an apology can resolve both simple interpersonal conflicts (Gonzales, Manning, and Haugen 1992; Hodgins, Liebeskind, and Schwartz 1996; Holtgraves 1989) and legal disputes (Tanick and Ayling 1996).

In situations where fault is denied, apologies indicate that the alleged wrongdoing does not accurately or fairly represent the true character of the actor (Schlenker 1980; Struthers, Eaton, Santelli, Uchiyama, and Shirvani 2008). By expressing one of the most critical components of an apology, remorse, the accused receives more favorable

evaluations and less severe sanctions (Tedeschi and Reiss 1981; Goffman 1971; Austin, Walster and Utne 1976).

Though individuals use apologies to express regret and remorse about a negative outcome, an apology is *not* synonymous with an admission of guilt or fault. When done appropriately, an apology can exist without an expression of wrongdoing. In fact, legal research specifically states defendants may apologize *without* admitting guilt:

“First, an apology is not necessarily equivalent to the admission of liability. ‘I’m sorry’ is not the same as ‘I’m at fault.’ ‘I’m sorry,’ is polite and human. Not to say, ‘I’m sorry’ is rude and arrogant. It has nothing to do with fault. Moreover, ‘I’m sorry’ in everyday speech usually means ‘I’m sorry we find ourselves in this current situation.’ It is not about fault.” (Kanazawa 2004, p. 32).

The mitigating effect of an apology results from the expression of sympathy and not from an acceptance of responsibility. Legal statutes in some states protect sympathetic apologies from being admissible as evidence. In 1986 Massachusetts was the first state to enact a law to protect apologies followed by Texas, California, Florida, Washington, and Colorado (Robbennolt 2003). As of 2007, 29 states had some form of “apology law” (Bender 2007).

Based on prior research in medicine and psychology, we hypothesize that the utilization of an apology will result in fewer negligence verdicts against an auditor when compared to jurors receiving no remedial tactic. We formally state Hypothesis 1 as follows:

H1: *Jurors’ negligence verdicts against an auditor will be lower when the auditor expresses an apology than when no remedial tactic is provided.*

First-Person Justification. Plaintiffs in negligence cases introduce outcome information as part of trial testimony in an effort to discredit defendants' prior decisions. Wood (1978) suggests that outcome knowledge (i.e., the "knew-it-all-along effect") alters individuals' perceptions of the inevitability of an event in hindsight (see also Christensen-Szalanski and William 1991). Thus, outcome knowledge can lead to negligence accusations despite the presence of uncertainty.

A defense strategy that involves the remedial tactic of first-person justification differs from other legal defenses that rely solely on third-party experts who testify about the correctness of defendants' actions. Although a first-person justification does not present new factual evidence (Blumstein et al. 1974), this strategy differs from testimony given by other witnesses because it provides specific insight into decision-making processes *directly* from the defendant.²

Goffman (1971) contends that the victim of a social offense often assumes the accused had a nefarious purpose when engaging in the questioned behavior. When an auditor fails to detect fraud or other material misstatements, the plaintiff may suggest possible motives such as negligence in performing professional duties, incompetence, or greed.

A first-person justification is a verbal statement the accused utilizes to assert the reasonableness or necessity of decisions made under uncertainty, and the person acted in a manner similar to anyone in like circumstances (Diekmann, Seibert, and Tynan 1997). Justifications attempt to change the impression of the original action from offensive to

acceptable (Schlenker 1980). Additionally, justifications prove effective when an “audience feels the account describes the real reason for the action” (Riordan, Marlin, and Kellogg 1983, p. 214).

When a first-person justification conveys that the decisions and actions were acceptable given the circumstances, it allows jurors to alter their impressions of the defendant’s actions. We hypothesize that a first-person justification will result in fewer negligence verdicts against auditors compared to a group receiving no remedial tactic. We formally state Hypothesis 2 as follows:

H2: *Jurors’ negligence verdicts against an auditor will be lower when the auditor expresses a first-person justification than when no remedial tactic is provided.*

Interaction of Remedial Tactics

Based on prior research examining individual remedial tactics and their effectiveness, we consider the interaction of justification and apology. We are not aware of any prior research that tests the combined use of two remedial tactics. Eaton, Stuthers, Shomrony, and Santelli (2007) suggest but do not empirically examine whether the effectiveness of an apology diminishes when offenders justify their actions. Specifically, they assert that the effectiveness of a justification may decrease when combined with an apology because individuals may misinterpret the justification for an excuse. Taft (2000) suggests that when a justification is combined with an apology, the recipient may view the apology as less sincere or view the defendant as less remorseful for the associated outcomes.

In Hypothesis 1 and Hypothesis 2, we predict that remedial tactics will cause lower frequencies of negligence verdicts compared to verdicts when jurors do not receive either tactic. While theory suggests apology and first-person justification operate in different ways, both tactics work to alter impressions resulting from negative outcomes. Thus, we believe that the presence or absence of one tactic will impact the effectiveness of the other. When an auditor expresses a(n) apology (justification), the addition of a(n) justification (apology) will moderate the benefit of the apology (justification). The impact of the apology (justification) will be stronger, resulting in fewer negligence verdicts, when a(n) justification (apology) is absent than when one is present. We formally state Hypothesis 3a and Hypothesis 3b as follows:

H3a: *Jurors' negligence verdicts against an auditor will be more positively affected by the expression of an apology when a justification is absent than when a justification is present.*

H3b: *Jurors' negligence verdicts against an auditor will be more positively affected by the expression of a justification when an apology is absent than when an apology is present.*

3. Experimental Methods

Research Design

We employed a 2 x 2 between-subjects design with apology (absent, present) and justification (absent, present) as independent variables. We adapted litigation case materials from Kadous (2001). The plaintiff, an investor who experienced substantial losses, alleged that the auditor acted negligently in measuring the inventory of a client (a gravel distributor). The facts of the case revealed that the client's management intentionally misstated inventory. The auditor issued an unqualified audit opinion, and the lawsuit accused the auditor of acting negligently by not discovering the fraudulent

behavior. The plaintiff argued that the audit firm's negligence also caused substantial loss to a creditor, bankruptcy for the gravel distributor, and job losses for company employees. The complete case consisted of the plaintiff's complaint; the respondent's answer; opening and closing statements from both parties' attorneys; witness testimony; expert witness testimony for the plaintiff and defendant; the judge's instructions to the jury; and in three of the four cases, testimony and responses to cross examination from an audit partner.³

When auditor negligence cases go to trial, defendants prevail at a rate of 46 percent to 54 percent (Palmrose 1991). We designed our control group to align with the verdict frequencies reported by Palmrose (1991) and to partially replicate Kadous (2001).⁴ This design provides a guilty percentage that allows us to test the impact of the treatments both in our planned direction (lower frequency of negligence verdicts) and in the alternative direction (greater frequency of negligence verdicts) to rule out alternative explanations.

We manipulated auditor apology at two levels (absent, present). In the apology condition, the auditor apologized for the *outcomes* referenced in the case without admitting guilt or providing any additional information surrounding the dispute. To increase the salience of the auditor's apology, the defense attorney referenced the apology in the closing statement.

We manipulated auditor first-person justification at two levels (absent, present). In the first-person justification condition, the auditor justified the decisions made during the audit. The auditor's testimony did not introduce any new facts to the case, but rather, the partner briefly reiterated the appropriateness of the firm's decisions. Similar to the apology condition, the defense attorney referenced the justification in the closing statement.

To examine the manner by which apology and justification together impact juror judgments, a treatment group received both tactics. In this case the auditor both apologized for the outcomes and provided a first-person justification of previous decisions.⁵ Figure 1 contains the wording added to the control case for each experimental group.

[Figure 1 about here]

Participants and Administration

We conducted an experiment utilizing 139 jury-eligible adults.⁶ To increase the diversity of our sample, we used two methods to solicit participants, in person and via the Internet. The paper-based materials for administering the study in person and the electronic version for administration via the Internet were identical. Non-business-major undergraduate students (n=89) completed the experiment in a classroom setting. We also acquired participants (n=50) using "chain" email, asking individuals to participate in the study and then forward the invitation to their address book contacts.⁷ The resulting sample includes participants from nine different states ranging in age from 19 to 66 years with a variety of educational, socio-economic, and geographic backgrounds.

We compared the Internet and paper-based groups for differences in demographics and negligence verdicts. No significant differences in either negligence verdicts or demographics were found between groups while controlling for experimental condition. The remainder of the analysis combines the results of both groups.

We randomly assigned participants to one of four experimental groups. We instructed participants to consider themselves as jurors in the case. Participants reviewed the case materials and evaluated the actions of the audit firm by assigning a verdict, which yielded a binary dependent variable for our primary analysis. Participants then completed additional questions regarding the trial followed by a post-study questionnaire including demographic information.

4. Results and Discussion

Manipulation Checks

To test the experimental manipulations, participants responded to questions regarding the auditor's testimony. Most participants, 121 out of 139 (87.1%), correctly identified whether the auditor testified.⁸ Unless otherwise noted, we measured all manipulation and other questions on a Likert-type 11-point scale anchored at 0 and 10 using two-tailed tests. Of those participants correctly recalling the auditor testimony who also received the apology manipulation, 54 of 61 (88.5%) correctly recalled the presence of the apology. For experimental conditions that included auditor testimony, we compared participants' responses who received the apology manipulation to those who did not receive an apology. Results indicate that participants perceived the auditor apologized for the

damages caused by the inventory misstatement ($t = 5.87, p < 0.001$, one-tailed) and the firm's audit work ($t = 5.23, p < 0.001$, one-tailed).⁹

To test the effectiveness of the justification manipulation, participants assessed the extent to which the auditor justified the firm's audit work. Participants receiving the justification manipulation correctly recognized that the auditor justified prior decisions as evidenced by differences in responses to this question from participants receiving auditor testimony but not the justification manipulation ($t = 2.86, p < 0.01$, one-tailed). Because the use of common words is not specific to our theory, we also measured responses to two synonyms for the word "justification." Participants who received the justification treatment indicated that the auditor rationalized ($t = 3.70, p < 0.001$, one-tailed) and explained ($t = 1.69, p < 0.05$, one-tailed) prior decisions significantly more than those who received auditor testimony but not the justification manipulation.

The results from the apology and justification manipulation questions show a distinct difference between participants who received remedial tactics and those who did not. We conclude that on average the potential jurors correctly recognized each remedial tactic manipulation.

Tests of Hypotheses

We conducted binary logistic regression and directional planned comparison analysis to test the influence of remedial tactics on negligence verdicts. Table 1 Panel A provides descriptive statistics for participants' negligence verdicts. Results of the logistic regression yield significant main effects for both apology ($p < 0.05$, one-tailed) and

justification ($p < 0.01$, one-tailed). We also find a significant interaction between treatments ($p < 0.05$, one-tailed). Table 1 Panel B presents the results of the logistic regression.¹⁰

[Table 1 about here]

Apology as a Remedial Tactic

We analyzed the planned comparisons using Fisher's exact test.¹¹ Results demonstrate a significant difference in verdicts between the control (no apology and no justification) and the apology condition, supporting H1 ($p = 0.04$, one-tailed). When an auditor testifies in an auditor litigation lawsuit and expresses an apology, jurors are less likely to find the auditor guilty of professional negligence.

We examined reactions to post-verdict questions between groups who received the apology and those who did not to examine the manner an apology causes a lower frequency of negligence verdicts. We asked participants to indicate the importance of determining blame for the outcomes as in Kadous (2001). Table 2 reports the results of comparing the group receiving the apology alone with the control group.

Results show that jurors' need to assign blame is lower in the apology group compared to the control group ($t = -2.34$, $p = 0.02$, two-tailed). The same influence of the need to assign blame does not exist when comparing the justification-only group to the control group ($t = -1.57$, $p = 0.12$, two-tailed), suggesting that an apology uniquely affects negligence judgments through this mechanism. In addition, we find a significant correlation between the jurors' need to assign blame and negligence verdicts in the

combined control and apology groups (Spearman's $\rho = .222, p < 0.05$). We do not observe the same relationship between jurors' need to assign blame and negligence verdicts in the other groups. We thus conclude that variation in jurors' need to assign blame is uniquely related to differences in negligence verdicts caused by the apology manipulation.

[Table 2 about here]

To determine whether the potential jurors viewed the apology as an admission of guilt, we asked participants to assess the extent the auditor accepted responsibility (liability) for the damages caused by the inventory misstatement anchored on “no responsibility” (“no liability”) and “extensive responsibility” (“extensive liability”). Participants did not believe the auditor either accepted responsibility (mean = 1.74, sd = 1.89) or accepted liability (mean = 1.18, sd = 1.51) for the damages. These findings are consistent with the notion that defendants can apologize during negligence litigation without accepting liability or admitting fault.

Justification as a Remedial Tactic

The results from the justification planned comparison indicate a significant difference in verdicts between the control and justification conditions supporting H2 ($p < 0.01$, one-tailed) as noted in Table 1 Panel C. When an auditor testifies in a negligence lawsuit and justifies prior decisions, jurors are less likely to find the auditor guilty of professional negligence.

A first-person justification allows the accused to clarify that decisions were reasonable or necessary given prior circumstances. This tactic should result in jurors viewing auditors'

actions as more appropriate. To gain insight into this concept, we asked participants to assess the auditor's responsibility to discover small misstatements in financial statements. We find that participants in the first-person justification group reported significantly lower assessments of "auditors' responsibilities to detect small misstatements in financial statements" when compared to the control group ($t = 2.42, p = 0.02$, two-tailed). In contrast, comparing the apology manipulation to the control group does not result in the same effect ($t = 1.34, p = 0.19$, two-tailed), suggesting that justification uniquely affects negligence judgments through this mechanism. In addition, we find a significant correlation between jurors' assessments of auditors' responsibilities to detect small misstatements and negligence verdicts in the combined control and justification groups (Spearman's $\rho = 0.291, p < 0.05$). We do not observe this same relationship in the other groups. Thus, we conclude that variation in jurors' assessments of auditors' responsibilities to detect small misstatements is uniquely related to differences in negligence verdicts caused by the justification manipulation.¹²

[Table 3 about here]

Interaction of Remedial Tactics

Hypothesis 3a predicts that the effect of auditor apology on jurors' negligence verdicts is moderated by the presence of a first-person justification. Tests of simple main effects indicate that when a justification is absent, an apology causes a lower frequency of negligence verdicts (47.1% versus 24.2% respectively, $p = 0.04$, one-tailed).

Alternatively, there is no significant difference in jurors' negligence verdicts when the auditor expresses an apology and justification is present (26.2% versus 16.7%

respectively, $p = 0.40$, two-tailed). These results support Hypothesis 3a. Figure 2 depicts this interaction graphically.

[Figure 2 about here]

Hypothesis 3b predicts that the presence of an apology moderates the effect of auditor first-person justification on jurors' negligence verdicts. Tests of simple main effects indicate that when an apology is absent, there is a significantly lower frequency of jurors' negligence verdicts (47.1% versus 16.7% respectively, $p < 0.01$, one-tailed).

Alternatively, differences between the percentages of jurors' negligence verdicts is not significant when the apology is present (26.2% versus 24.2% respectively, $p = 0.99$; two-tailed), which supports Hypothesis 3b.¹³

To further investigate the interaction of both remedial tactics, we examined the jurors' need to assign blame and their perceptions of the auditor's professional responsibilities. We find that the combination of the apology and justification treatments does not provide a significantly different level of jurors' need to assign blame compared to the group receiving only the apology ($t = -1.13$, $p = 0.26$, two-tailed) or only the justification ($t = -0.34$, $p = 0.74$, two-tailed). Also, the combination of apology and justification does not incrementally alter jurors' assessments of auditors' professional responsibility to detect immaterial misstatements when compared to responses of those receiving only the apology ($t = 0.40$, $p = 0.69$; two-tailed) or justification ($t = 1.56$, $p = 0.12$; two-tailed).

We examined whether combining tactics is detrimental to the effectiveness of each tactic used alone by testing whether jurors perceived the apology as less sincere. We find no

significant difference between jurors' impressions of the apology's sincerity ($t = 0.05$, $p = 0.96$, two-tailed) when the defendant expresses only an apology compared to the group with both an apology and justification.

Finally, we examined whether jurors viewed the combination of an apology with a justification as excuse-making. We asked participants to rate the extent to which the auditor provided excuses during testimony and compared the justification group to the group receiving both tactics. Results indicate no significant difference between the two groups ($t = 0.51$, $p = 0.62$, two-tailed).

Results associated with Hypothesis 3a and Hypothesis 3b support our predictions that apology and justification work in different manners to cause a lower frequency of negligence verdicts against auditors. Based on our design and analysis, we conclude that each remedial tactic acts as a substitute with no added benefit to the combined use of remedial tactics.

Jurors' Perceptions of Auditors' Responsibilities to Detect Fraud

Auditors should be judged based on the quality of their audit and not on outcomes associated with events beyond their control. Prior research has found that in hindsight, judges assess auditors' past performance more harshly than do other auditors. These differences in assessments reflect an expectation gap between auditors' actual and perceived roles (Anderson, Lowe, and Reckers 1993). Auditors remain concerned about the expectation gap between stakeholders' perceptions of their responsibility to detect fraud and the intended purpose of an audit (McEnroe and Martens 2001; Taub 2005).

We examined the influence of remedial tactics on participants' perceptions of auditors' responsibilities to detect fraud using a question anchored at "no responsibility" and "extensive responsibility." We conducted mediation analysis to examine the overall effect of remedial tactics and juror assessments of fraud responsibility on negligence verdicts. Consistent with the discussion in Kenny, Kashy, and Bolger (1998) and analysis performed by Shankar and Tan (2006), two steps are required to show mediation: a significant relationship exists between independent variables and the mediating variable, and the significance of the independent variables decreases when the mediator is included in the model.

Our results satisfy both conditions. First, apology and justification are both significantly correlated with the mediating variable, jurors' assessments of the auditors responsibility to detect fraud (Spearman's $\rho = .159, p = 0.03$ and Spearman's $\rho = .163, p = 0.03$, respectively). Second, in Panel C of Table 4 we show that in a complete model including the mediating variable, perceptions of the auditor's responsibility to detect fraud is significant (Wald = 14.121, $p < .001$, two-tailed) while the influence of the interaction is statistically insignificant (Wald = 2.535, $p = 0.11$, two-tailed). As the interaction term is statistically insignificant when the mediator is present, a total mediation of the relationship exists between remedial tactics and negligence verdicts by perceptions of auditors' responsibilities to detect fraud. Thus, remedial tactics may decrease the expectation gap between stakeholders' perceptions of auditors' responsibilities to detect fraud and the intended purpose of an audit.

5. Conclusion, Limitations and Future Research

Our research examines the influence of remedial tactics on jurors' judgments in auditor negligence litigation. A primary problem affecting auditors is the disparity between the services auditors provide and the expectations of financial statement users. Auditors attempt to manage the liability associated with this disparity by strictly following professional standards. Plaintiffs seeking damages for economic losses often accuse auditors of negligence and influence jurors by focusing on the negative outcomes rather than on a clear determination of fault. Tan and Tan (2008) show erroneous information can continue to influence individuals' judgments even subsequent to correction of that information. Auditors may choose to use remedial tactics to help counteract this influence.

Prior research has shown that remedial tactics can decrease liability expenses for medical providers. We experimentally examine remedial tactics and note three distinctions between a medical setting and an auditor litigation trial. We conclude that apology and first-person justification cause lower frequencies of negligence verdicts when compared to jurors not receiving any remedial tactic. These remedial tactics act as substitutes, and results indicate no added benefit of using both remedial tactics together rather than individually.

Though the plaintiff in any case may attempt to directly link negative outcomes to auditor actions, our findings suggest that remedial tactics may mitigate the plaintiff's complaint. Apologies result in lower levels of jurors' need to assign blame to the auditor for the

negative outcomes. A first-person justification influences observers' impressions that the auditor's actions were reasonable and in accordance with professional standards.

Justifying prior actions during testimony and linking assurance services to codified standards may well prove successful in achieving favorable litigation outcomes.

Importantly, the positive effects of apology and justification are also manifest by altered assessments of auditors' obligation to detect fraud.

Prior research in psychology, management, and medicine has found that remedial tactics are effective when provided directly to an injured party. In our research, the observer juror was not harmed and therefore cannot directly forgive the accused. We extend existing theory by providing evidence that remedial tactics are also effective when expressed to an unharmed, third-party observer.

Though the results of this study provide insight into negligence litigation against auditors, limitations do exist. We do not examine varying circumstances in which each tactic may be more or less appropriate. Our results support the effectiveness of remedial tactics generally, but future research could assess situational or contextual settings in which one tactic would be preferable to another.

The introduction of remedial tactics required the introduction of an auditor's testimony into evidence for the apology and justification treatments. Based on discussions with litigation attorneys and review of relevant literature, we did not have the auditor testify in

the control group. This design precludes us from asserting conclusively that auditor testimony containing only information previously presented would not alter the verdict.

Our study provides evidence that remedial tactics cause fewer negligence verdicts against an auditor when expressed by the accused to an unharmed third party. Future research could investigate whether the same results occur if jurors received the tactics from someone other than the accused. For example, future research could examine whether third-person remedial tactics, such as having an attorney apologize on behalf of a client, lessen the frequency of negligence verdicts against auditors.

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TABLE 1
Analysis of negligence verdicts against the auditor

Panel A: Negligence frequencies by group*

		Apology		
		No	Yes	
Justification	No	Control 47.1% (16 / 34)	Apology 24.2% (8 / 33)	35.8% (24 / 67)
	Yes	Justification 16.7% (5 / 30)	Both 26.2% (11 / 42)	22.2% (16 / 72)
		32.8% (21 / 64)	25.3% (19 / 75)	28.8% (40 / 139)

Panel B: Logistic regression

Effect	B	S.E.	Wald	df	<i>p</i> -value [†]
Apology	-1.022	0.532	3.688	1	< 0.05
Justification	-1.492	0.598	6.214	1	< 0.01
Apology * Justification	1.595	0.804	3.937	1	< 0.05

Panel C: Fisher's exact test

Comparison	df	<i>p</i> -value
Apology vs. Control	1	0.04 [†]
Justification vs. Control	1	< 0.01 [†]
Apology vs. Both	1	0.99 [‡]
Justification vs. Both	1	0.40 [‡]

Notes:

* After reading all materials, participants rendered a verdict indicating that the audit firm was guilty or not guilty of negligence. Cell percentages reflect rate of negligence verdicts against the auditor.

† One-tailed

‡ Two-tailed

TABLE 2

Jurors' need to assign blame

Panel A: Descriptive statistics*

		Apology		
		No	Yes	
Justification	No	Control	Apology	
	Mean	7.7	6.4	7.0
	SD	(1.7)	(2.8)	(2.4)
	Yes	Justification	Both	
	Mean	6.9	7.1	7.0
	SD	(2.5)	(2.6)	(2.5)
		7.3	6.8	
		(2.1)	(2.7)	

Panel B: Analysis of Variance

Source	df	Mean Square	<i>F</i> -value	<i>p</i> -value [†]
Apology	1	10.731	1.809	0.18
Justification	1	0.123	0.021	0.89
Apology * Justification	1	20.038	3.378	0.07
Error	135	5.931		

Panel C: Comparison of means analysis

Comparison	t	df	<i>p</i> -value [†]
Apology vs. Control	-2.34	66	0.02
Justification vs. Control	-1.57	63	0.12
Apology vs. Both	-1.13	74	0.26
Justification vs. Both	-0.34	71	0.74

Notes:

* Participants responded to a Likert-type item (anchored at 0 and 10) asking how important it was to figure out who was to blame for the events described in the case.

† Two-tailed

TABLE 3

Jurors' expectations of auditors' professional responsibilities

Panel A: Descriptive statistics*

		Apology		
		No	Yes	
Justification	No	Control	Apology	
	Mean	5.7	6.5	6.1
	SD	(2.9)	(2.4)	(2.7)
	Yes	Justification	Both	
	Mean	7.3	6.3	6.7
	SD	(2.5)	(2.8)	(2.7)
		6.4	6.4	
		(2.8)	(2.6)	

Panel B: Analysis of Variance

Source	df	Mean Square	F-value	p-value [†]
Apology	1	0.145	0.020	0.89
Justification	1	16.046	2.273	0.13
Apology * Justification	1	29.664	4.202	0.04
Error	135	7.059		

Panel C: Comparison of means analysis

Comparison	t	df	p-value [†]
Apology vs. Control	1.34	66	0.19
Justification vs. Control	2.42	63	0.02
Apology vs. Both	0.40	74	0.69
Justification vs. Both	1.56	71	0.12

Notes:

* Participants responded to a Likert-type item (anchored at 0 and 10) asking for level of agreement that auditors cannot be expected to discover small misstatements in financial statements because the level of detail of their tests has to be limited.

† Two-tailed

TABLE 4

Jurors' expectations of auditors' responsibilities to detect fraud

Panel A: Descriptive statistics*

		Apology		
		No	Yes	
Justification	No	Control	Apology	
	Mean	6.9	5.6	6.2
	SD	(2.5)	(2.5)	(2.6)
	Yes	Justification	Both	
	Mean	5.5	5.2	5.3
	SD	(2.6)	(2.8)	(2.7)
		6.2	5.4	
		(2.6)	(2.7)	

Panel B: Comparison of means analysis

Comparison	t	df	p-value [‡]
Apology vs. Control	2.129	66	0.04
Justification vs. Control	2.160	63	0.03
Apology vs. Both	- 0.506	74	0.62
Justification vs. Both	- 0.363	71	0.72

Panel C: Mediation effect of fraud responsibility on negligence verdicts[†]

Effect	B	S.E.	Wald	df	p-value [‡]
Apology	-0.848	.586	2.093	1	0.15
Justification	-1.169	.639	3.350	1	0.07
Apology * Justification	1.390	.873	2.535	1	0.11
Fraud Detection Responsibility	0.353	.094	14.121	1	< 0.01

Notes:

* Participants responded to a Likert-type item (0-10 scale) asking for level of agreement that the auditor is responsible for actively searching for every small instance of fraud.

† Panel C reports the results of a binary logistic regression with negligence verdicts as the dependent variable and jurors' perceptions of the auditor's responsibility to detect fraud as a mediating variable. Table 1 provides descriptive statistics for the dependent variable.

‡ Two-tailed

FIGURE 1

Experimental materials and manipulations

The complete case consisted of the: 1) Plaintiff's complaint; 2) Respondent's answer; 3) Plaintiff and defense attorneys' opening and closing statements; 4) Witness testimony; 5) Expert witness testimony for each side of the case; 6) Judge's instructions to the jury; and 7) Testimony and responses to cross examination from an audit partner (except in the control group).

The experimental manipulations contained the following additional wording from the audit partner and subsequent cross-examination:

Apology Group: Jones & Company has a long history of performing high-quality audits. We work hard to protect the integrity of our company and the auditing profession. I apologize that an audit was not able to detect the inventory misstatement.

Cross-examination: I understand Bierhoff relied on the audit to extend a loan to Big Time Gravel. I'm sorry they experienced a loss on their investment.

Justification Group: Jones and Company has a long history of performing high-quality audits. We work hard to protect the integrity of our company and the auditing profession. I appreciate this opportunity to explain and justify the actions our firm took in auditing Big Time Gravel. We performed a high-quality audit of Big Time Gravel. Auditors cannot be expected to find every error in a company. We provide reasonable assurance that the financial statements are fairly stated. Users of financial statements—especially creditors—are expected to perform their own research to verify the conclusions made by an auditor. Since we did the job according to professional standards, we cannot be responsible for events outside the scope of an audit.

Cross-examination: There is always a chance that an audit will miss a material misstatement. We cannot provide a 100% guarantee; it's impossible. Generally Accepted Auditing Standards require us to provide reasonable assurance against material misstatements. We performed an audit according to these standards.

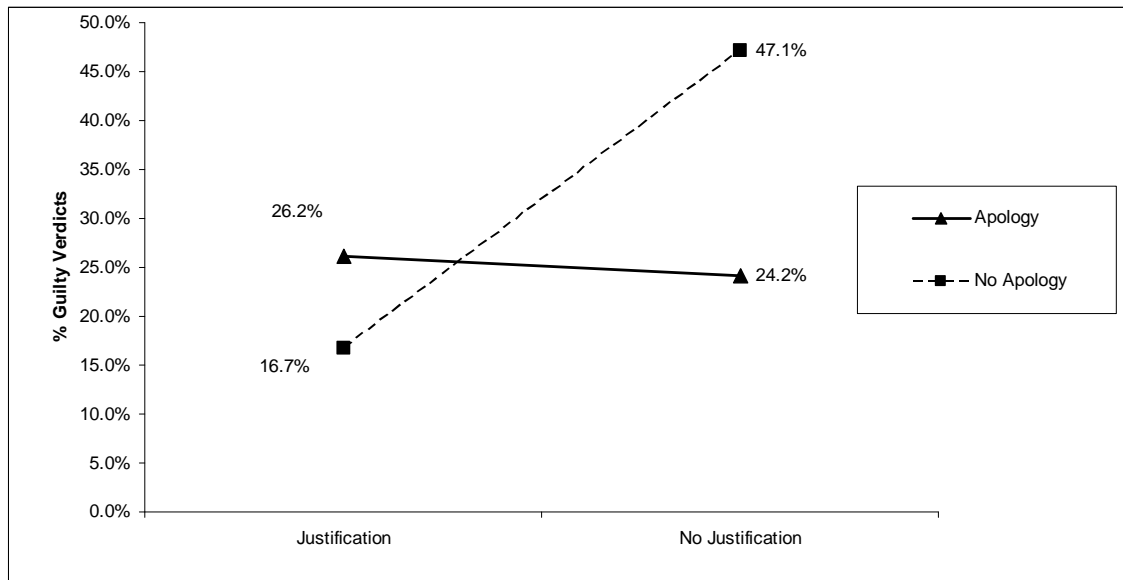
Apology and Justification Group: Jones & Company has a long history of performing high-quality audits. We work hard to protect the integrity of our company and the auditing profession. I apologize that an audit was not able to detect the inventory misstatement. I also appreciate this opportunity to explain and justify the actions our firm took in auditing Big Time Gravel. We performed a high-quality audit of Big Time Gravel. Auditors cannot be expected to find every error in a company. We provide reasonable assurance that the financial statements are fairly stated. Users of financial statements—especially creditors—are expected to perform their own research to verify the conclusions made by an auditor. Since we did the job according to professional standards, we cannot be responsible for events outside the scope of an audit.

Cross-examination: There is always a chance that an audit will miss a material misstatement. We cannot provide a 100% guarantee; it's impossible. Generally Accepted Auditing Standards require us to provide reasonable assurance against material misstatements. We performed an audit according to these standards.

I understand Bierhoff relied on an audit to extend a loan to Big Time Gravel. I'm sorry they experienced a loss on their investment. However, we cannot be held responsible for business losses from every organization that decides to do business with Big Time Gravel. Our job is to perform a good audit according to professional standards, which we did in this case.

FIGURE 2

Negligence verdicts against the auditor conditioned on presence of justification



ENDNOTES

¹ Another type of account is an explanation. Explanations are used when outcomes are favorable, while justifications are used when outcomes are unfavorable (Blumstein et al. 1974).

² Plaintiffs can compel defendants to testify in civil litigation in the United States. When the plaintiff does not subpoena the auditor to testify, the defense team must consider the risks of the auditor testifying, including aggressive cross examination by plaintiffs' attorneys, the potential to misspeak, and the possibility that the jury will dislike or not find the auditor credible (Mensch 2003).

³ The auditor did not testify in the control group because we developed this condition to provide a baseline for the comparison of the treatment groups. Alternative control groups in which an auditor's testimony consisted of precise words already presented or in which the auditor appears and no testimony is provided would compromise realism.

⁴ Kadous (2001) examined affective attribution, outcomes surrounding an audit, and audit quality on juror negligence verdicts. For comparison purposes, we provided participants in our control group the same materials as the no attribution, negative outcome, high audit quality group reported in Kadous.

⁵ To help incorporate the use of both manipulations, we added two additional sentences to this experimental group's materials. To test whether this additional wording affected our results, we eliminated this extra wording and administered the materials to 26 additional participants whose responses are not included in the results. The frequency of negligence verdicts between the two versions was not significant ($p > 0.30$, two-tailed).

⁶ Since jurisdictions vary in requirements for potential jurors, we used the most common juror attributes and define "jury-eligible participants" as United States citizens age 18 or older. Discussions with two negligence litigation attorneys indicated a bias against jurors with substantial experience in accounting generally and auditing specifically. Following this advice and Kadous (2001), we intentionally solicited and included participants who were not attorneys or accountants.

⁷ We compared the time-stamps on the Internet-based responses between the *control* group (shortest length) and the *both* tactics group (longest length). We did not find a significant difference of the completion time between the two conditions ($p > 0.60$, two-tailed).

⁸ We implemented electronic controls to prohibit Internet participants from viewing the transcript after responding to questions related to the verdict. Written case instructions clearly instructed participants not to refer to the case materials when answering these questions.

⁹ Sincerity is a necessary but insufficient component for an effective apology (see Risen and Gilovich 2007 for a discussion). When compared to a point on the rating scale indicating neutral sincerity, responses suggest that participants perceived the apology as sincere ($t = 3.80$, $p < 0.001$, one-tailed).

¹⁰ Experimental materials also included measures of participants' audit familiarity, time to complete the study, method of data collection, and demographics. We evaluated each variable as a possible covariate and found them all to be insignificant (results not reported).

¹¹ Fisher's exact test is a robust non-parametric method for testing simple main effects that examines differences in data expressed as proportions or percentages and does not rely on distributional assumptions (Hays 1994). This analysis is appropriate when a data set is small, sparse, or skewed (Conover 1999).

¹² We asked participants to respond to an item indicating the appropriateness of the auditor's actions. Participants in the justification and apology groups both perceived the actions of the auditor as more appropriate than those in the control group ($t = 2.75, p = 0.03$, and $t = 2.11, p = 0.04$ respectively, both two-tailed), indicating that both treatments changed the impression of the appropriateness of auditor actions.

¹³ We performed an additional analysis of the main hypotheses by eliminating participants who failed the manipulation check. In all cases, the statistical results yield the same conclusions: H1: $p = 0.03$, one-tailed; H2: $p < 0.001$, one-tailed; H3a: $p = 0.16$, two-tailed; and H3b: $p = 0.99$; two-tailed.