

OSTROM WORKSHOP RESEARCH SERIES

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Ostrom Workshop Visiting Scholar

“Auditor Reputation Losses, Legal Liability Damages, and Standards”

Wednesday, October 19, 2016

12:00 – 1:00 p.m. • Ostrom Workshop, 513 N. Park

This paper studies the effect of legal liability damages when an auditor is concerned about avoiding a decline in the outside market’s perception about his ability. Reputation losses due to the loss of future clients provide incentives for the auditor to supply costly audit quality. However, with legal liability damages, there is an option of noncompliance, where audit quality is lower than the minimum threshold set in the standards. If standards are lax, with compliance audit quality is higher than the minimum threshold because of reputation concerns, which is costly in equilibrium. Thus, if legal liability damages are not too high, the auditor may choose noncompliance and lower audit quality than what would be optimal with only reputation losses. Further, when considering preferences for the strictness of standards, the investors always have a preference for stricter standards than the auditor, but reputation effects can dampen the difference.



Naomi Rothenberg is an assistant professor in accounting at the University of Alberta. Her work focuses on incentives for financial reporting quality and how asymmetric information in settings with multiple managers affects issues related to reporting and dissemination of information, including performance measurement, organization of production, and the effect of disclosure on competition. Her work has been published in *The Accounting Review*, *Contemporary Accounting Research*, *Journal of Management Accounting*, and *Management Accounting Research* ([website](#)).

Presentations are open to the public (see our website for papers). You are welcome to bring your lunch. For questions, contact Allison Sturgeon (sturgeon@iu.edu; 812/855–3151).