

A Circle of Influence: Are All the Stakeholders Included?

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ABSTRACT. Traditionally, certified public accountants (CPAs) have served a unique role in the world of commerce and the profession of accounting. They perform an attest function and thereby serve as the chief providers of relevant, high quality accounting information to the decision making public. CPAs are licensed practitioners, who as expert independent accountants express opinions about an entity's financial statements. Their license provides them with the exclusive right to perform this attest function. This monopoly relies on the concept of independence that is the normative standard of accountancy. It is this perceived independence of auditors which provides credibility, reliability and trust in the financial accounting information upon which stakeholders depend to make informed decisions. Now, however, we see the environment in which CPAs operate undergoing rapid change. Both the globalization of business operations and technological advances have radically changed how and where accountants work and the speed at which things happen. The very nature of accounting information services is evolving; moving from a concentration on audits to an increasing reliance on consulting and assurance services. New ethical issues have been raised by this confluence of changes in the accounting environment. Noteworthy is that the application of the principle of independence by CPAs has been called into question by no other than the SEC. Are those stakeholders who depend upon the independence of CPAs at risk? The influence of insiders has significantly increased as accounting firms perform multiple tasks for the same clients. This paper discusses the different groups who can potentially impair the independence

of auditors and the steps that are being taken to enhance the "independence" of the auditors.

KEYWORDS: auditor independence, consulting services and independence of auditors, independence standards board

Traditionally, certified public accountants (CPAs) have served a unique role in the world of commerce and the profession of accounting. They perform an attest function and thereby serve as the chief providers of relevant, high quality accounting information to the decision making public. Attestation is the certifying by signature, that in their opinion, the audited financial statements are fairly presented (unbiased) and free from material misstatement (anything that would make a difference in the decisions made). CPAs are licensed practitioners, who as expert independent accountants express opinions about an entity's financial statements. Their license provides them with the exclusive right to perform this attest function. This monopoly relies on the concept of independence that is the normative standard of accountancy. Independence allows the professional to uphold an image of ethical propriety (Mautz and Sharaf). Independence also demands legal restrictions of the auditing profession in terms of ownership of, investment in and management of public clients. Not only have the CPAs served a unique function in furthering commerce, but financial accounting itself provides the structure through which business operates and reports its results to investors and other interested stakeholders. Financial accounting information exists solely because of its value to decision-makers. This

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accounting information is relied upon by many stakeholders, including but not limited to investors and creditors, to make informed business decisions.

Now, however, we see the environment in which CPAs operate undergoing rapid change. Both the globalization of business operations and technological advances have radically changed how and where accountants work and the speed at which things happen. The very nature of accounting information services is evolving; moving from a concentration on audits to an increasing reliance on consulting and assurance services. Consulting involves providing services other than auditing to the client, generally by different members of the firm or related firms. These services can be in areas such as internal auditing, investment advice, tax, or information systems development. Assurance services are an extension of auditing applied to providing assurance about the relevance and reliability of non-financial information and information systems. Accounting firms are earning an increasing proportion of their revenues from consulting work (It is expected to account for two-thirds of revenue by the year 2000) (Schultz). Consulting services rely more heavily on nonfinancial information, information systems and non-CPAs (Elliott). Additionally, the development of the internet, which is altering the way business is conducted, has created another assurance service area for accountants. An expressed need to assure consumers of a web site's legitimacy and its ability to protect the privacy and security of their personal information has resulted in this new assurance service. To give confidence to this electronic commerce, "a new service and unique seal of assurance were developed by a joint task force of the AICPA and the Canadian Institute of Chartered Accountants (CICA). This seal is called Web Trust.sm" (Web Trust). This seal of assurance, like the audit opinion, rests on the expertise and reputation of CPAs.

New ethical issues have been raised by this confluence of changes in the accounting environment. Noteworthy is that the application of the principle of independence by CPAs has been called into question by non other than the SEC (New). Studies have indicated that accounting

firms are increasingly relying on consulting and other services to generate revenue, possibly even treating auditing as a loss-leader to maintain a foot in the door of companies. Accordingly in December of 1996, SEC Chairman Arthur Levitt warned the accounting industry not to lose sight of their core job, overseeing and opining on corporate financial statements. He said the accounting profession "may be discounting the huge importance investors place on the objectivity and independence of auditors" [Dow Jones News Service]. Independence is the philosophical foundation of the profession (Kell). The attribute of independence is a very specialized concept for accountants. In seeking to maintain the highest ethical standard for the accounting profession, independence is defined as the quality of being free from influence, persuasion or bias; it is objective. An independent auditor is expected to be without bias with respect to the client under audit and should appear to be objective to those relying on the results of the audit. It is this perceived independence of auditors which provides credibility, reliability and trust in the financial accounting information upon which stakeholders depend to make informed decisions.

Are those stakeholders who depend upon the independence of CPAs at risk? Certified public accountants are bound by the AICPA Code of Professional Conduct that identifies six principles that must be followed. In addition to the requirement to recognize their responsibilities to exercise sensitive and moral judgements in all their activities; serve the public trust; perform all professional responsibilities with the highest sense of integrity; and practice due care, a certified public accountant must demonstrate objectivity and independence (AICPA).

"A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities . . . be independent in fact and appearance when providing auditing and other attestation services" [AICPA].

However, one only has to look at the politics involved in financial accounting to recognize that the specter of the fox in the hen house has been raised. Politics has been defined as "an attempt by individuals or groups to change or influence who gets what, not based on economic decision

making, but the individuals or groups obtaining, holding and exercising institutional or social power" (Owens, 9). This political dimension can be seen as a circle of influence that separates insiders and outsiders. The ethical challenge will be to open up the circle, assuring outsiders the same advantages as insiders. We can see how those now inside the circle exert influence, if we recognize that financial reports are prepared by senior managers, who have a vested interest in the content of those reports, since many of the decisions made by owners (stockholders represented by the board of directors) will directly impact them. Furthermore, corporations and accountants frequently exert influence about the development of generally accepted accounting principles (GAAP). However, the final decisions about what constitutes GAAP are made by the Financial Accounting Standards Board (FASB), an independent, privately financed rule-making organization. This private financing comes primarily from corporations and accounting firms. Since this confluence of interested parties borders on conflict of interest, the SEC created regulations to provide credibility. These regulations require that financial reports be prepared according to GAAP and audited by independent CPAs who can attest or opine on the fairness of the presentation of the statements. However, while auditors are technically hired by and report to an audit committee of the board of directors (composed of outside directors) they are paid by those corporations (senior managers)! This circle of interested parties creates the potential for conflicts of interest (Owens). Another ethical concern involves the possible impairment of independence at least in appearance, due to the emergence of the importance of consulting work to accounting firms as well as the development of new complex business and professional relationships. The influence of insiders has significantly increased as accounting firms perform multiple tasks for the same clients.

Troubled by this developing potential impairment of auditor independence in appearance if not in fact, the SEC called for a study of the issue and new standards in the spring of 1997. In response, the AICPA, which is very concerned with maintaining its monopoly of the attest

function, joined with the SEC to establish a new regulatory body, the Independence Standards Board (ISB), to set independence standards for auditors of public companies (New). This board is composed of both accountants and representatives from industry. One of the tasks of the ISB is to develop a clear understanding of the issues.

To this end, in October 1997, the AICPA submitted a white paper to the board outlining their perception of the issues as well as suggested solutions. In December, the SEC issued formal comments in response to this white paper. The most important comment was a concern that the report only presented the point of view of the practicing profession, particularly that of the large firms and consequently fails to present a balanced view of the issues. The SEC also noted that additional research is still necessary to provide an understanding of the issues from the investor's point of view (Carmichael). It is apparent that even the AICPA can be part of the insiders' circle of influence excluding the outsiders, even when those outsiders are other accountants.

After eight months of operations, the new Independent Standards Board has done little more than propose that auditors send a short form letter to company directors each year stating that they are independent. However, because of concern about the growing ties between auditors and the companies they audit, Lynn Turner, the SEC's chief accountant, made a proposal to the Independent Standards Board on September 1, 1998 [Petersen]. He proposed that auditors should instead meet annually with company directors to explain why the consulting services they have performed for the company have not interfered with the auditor's independence. Mr. Turner does not believe that a letter alone would be sufficient to address the SEC's concern. He recommended that at an annual meeting of the auditors and the company audit committee, there be a discussion of the details and cost of consulting work that the auditing firm provides to the company including an explanation of why the provision of those services did not impair the independence of the auditors. The SEC is also addressing the issue of auditors accepting positions at the company they audit. They would

prevent an auditor from immediately accepting a job from a company they audit. Once again, they are concerned with the potential appearance of impaired independence by the auditor.

Due to this concern about the potential conflicts of interest of auditors, the SEC is increasing its oversight of merger and acquisition consulting work done by auditing firms for their SEC clients. In response to the accounting scandals reported at such companies as Cendant and Sunbeam, they have announced that accounting-related issues will be a primary focus for their enforcement division this year (MacDonald).

The Independence Standards Board (ISB) is now also considering a new rule, expected to be issued shortly, that would require auditors to disclose to corporate audit committees any consulting services that they provide to their companies. Auditors would also be required to disclose any relationships they have with corporate clients, including the names of any relatives who work at those companies. If enacted, this rule would become effective for fiscal years ending after July 15, 1999 (MacDonald). The SEC also has under consideration, a proposal that would require all reporting companies, to disclose the extent of consulting services that their auditors provide within their financial filings. Such disclosures have not been made since 1981 (MacDonald).

As new standards of independence are established, even though they will only specifically apply to auditors of public companies, the bar will be raised for the rest of the profession. It will be a very strong commitment to real independence, which should be a beacon for ethical behavior and decision making. Already, the most often discussed questions that accountants raise and that are investigated by the various organizational committees charged with overseeing ethics are related to this concept of independence. It is one of the most difficult principles to define and evaluate. The ethical decisions that accountants make about their independence and objectivity need to be more than just compliance decisions, they need to be based on a very strong sense of personal integrity that will assure that the circle of influence is not exclusive and that all stakeholders will be equally advantaged and

included within the circle. An unbiased circle of providers and users of accounting information would include the opinions and needs of all stakeholders; investors, suppliers, creditors, employees, customers, professional organizations, and government authorities. It would be hoped that the highest ethical standards will be identified and practiced to meet the needs of decision makers and all stakeholders to move the accounting profession into the next millenium as the repository of consumer trust.

This changing environment of accounting holds an implication for the future of accounting education. As educators, we will have to prepare students to expect and deal with continual change in their careers. They will need to develop an awareness of the circle of influence that potentially impairs independence. We can assist them in identifying all of the stakeholders that rely on the integrity of the information services provided by accountants. Students can be made aware of the importance of their own personal integrity. They need to recognize their ethical responsibility to be truly independent in fact and appearance when they advise and counsel clients. We would hope that they can sharpen their ethical decision making skills regularly so that the advice and counsel they give clients on such things as the choice of alternative accounting treatments will be based on the recognition of the interests of all stakeholders not just those in the inner circle.

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