

P E R S P E C T I V E S  
personal viewpoint

# Don't Shrink from the Challenge; Stand Up and Do What's Right

By Larry A. Deppe, Ronald M. Mano, and Matthew Mouritsen

**T**he accounting profession is facing great challenges. Federal and state regulatory bodies, investors, public interest groups such as Ralph Nader's Association for Integrity in Accounting, and the public at large are demanding professional independence and accountability. Many view the accounting profession as the culprit in precipitating the recent bull market.

Sadly, the actions of a relatively small number of accountants have cast a shadow over the entire profession. Government intervention has been swift and decisive. Accountants, both public and private, have been led away in handcuffs. Meanwhile, skeptics gloomily question the continued existence of the profession.

The Utah Association of Certified Public Accountants (UACPA) decided to confront the problems head on. Under the leadership of President Marty Van Wagoner, President-Elect Troy Lewis, Vice President Susan Speirs, and CEO Jeannie Patton, the Association held a day-long conference of 65 member CPAs from sole practices, local firms, national firms, business and management, education, and government to consider the future of the CPA profession.

### Laying the Foundation

The conference was designed to do four things:

- Inform the participants of the effects of recent events on the accounting profession.
- Provide an opportunity for CPAs to discuss the effects of these events on all segments of the profession.
- Engage participants from each segment of the profession in the process of developing recommendations for actions designed to address the

issues and problems confronting the profession.

- Provide a forum for an exchange of ideas among the various segments of the profession.

The first half of the program featured an update on recent developments affecting the accounting profession. The provisions of the Sarbanes-Oxley Act (SOA) were presented, as well as their potential impact on the profession. In the second half of the day, participants formed working groups along the following segments of practice: national public accounting firms; local public accounting firms; sole practitioners in public accounting; business and industry; education; and government. The conference placed an emphasis on creating a true dialogue between professionals and avoiding adversarial debate.

A task force was created to take the conference proceedings and prepare a white paper presenting recommendations to the profession. The UACPA executive board planned to use the information from the conference as a guide in formulating a plan of action for the leadership of the association. The UACPA staff planned to use the information in developing continuing education and conference sessions.

### Capturing Insights

The next step was to capture participants' ideas. Participants were asked, "What information do you need?" Participants were told to individually write down their questions or issues. Participants at each table were then instructed to appoint a spokesperson and a recorder, and begin a group dis-

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discussion on a second set of questions: "What additional information do you need, or what questions do you have?" Afterward, each group recorded its top three items on a flipchart and reported them to the entire conference via the spokesperson. The earlier notes were retained.

The second major question was, "What in all of this can we have an impact on?" The profession cannot address every problem and issue confronting it at once. Participants were asked to consider two criteria: What are specific actions in specific areas that individual CPAs in my segment can and should take? What are specific actions in specific areas that firms, companies, governmental units, and educational institutions can and should take?

Again, participants were asked to work individually first before discussing those ideas in a group. Each table's top three items were recorded on flipcharts and reported to the entire conference via the spokespeople. All notes were retained.

The final question posed was, "What would constitute a real breakthrough for the profession?" The same procedure was applied. By this point, major themes had emerged from the previous discussions (see *Exhibit 1*), and participants were now asked to select the top three breakthroughs for their segment. The goal was to identify long-term solutions rather than short-term remedies. The proposed solutions should be capable of providing the profession with a sound and viable future. These solutions should serve to begin closing the expectation gap in all segments of the profession. The breakthroughs are presented in *Exhibit 2*.

### White Paper

The information generated was organized and assembled into a white paper and distributed to all UACPA members. The report was divided into four sections:

- The accounting business model
- Professional ethics
- Regulation of the profession
- Image and reputation.

Each section contained background information on the specific topic, examined the current status regarding the topic, discussed issues relating to the topic as well as opportunities for change, and provided

recommendations for CPAs in each segment of the profession.

**The accounting business model.** There has been a longstanding debate over whether an accountant in public practice could maintain auditor independence while providing management advice and services. Housing an audit practice, with its strict rules of professional conduct, within a consulting firm not subject to the same stringent rules of conduct posed a formidable challenge. Although SOA mandated a solution to the consulting issue, serious questions regarding the auditor/client relationship persist.

Whom does the independent auditor serve: The company that pays the fees, or its shareholders? Can an auditor become so dependent upon one company that independence is compromised in order to retain its business? Should engagement partners be rotated periodically?

Independence is not the province of the auditor alone. Corporate governance procedures play a major role not only in maintaining auditor independence but also in deterring behavior like earnings management. Membership on corporate boards should not be a function of celebrity or cronyism. Board members must be productive contributors to the corporate governance process, including auditor independence.

In recent years, the accounting standards-setting process has been criticized for being slow and ponderous, as well as for producing results that do not reflect economic reality. Standards setting has degenerated from due process involving constituents to congressional oversight involving lobbyists. SOA marks the beginning of a new level of government oversight of the standards-setting process. The increased authority behind accounting standards presents the very real possibility that standards intended for public companies will be seen as universally applicable to all entities, particularly those where a public interest is perceived to exist. The "trickle-down" of earlier SEC standards thus may become a cascading waterfall of new standards applicable to entities for which the standards (new or old) were never intended, with costs that will be onerous.

Conference participants views on these issues included the following:

**Independence.** Public accountants supported strong boards of independent directors. Auditors should meet with the board in the absence of management. Public practitioners also viewed partner-rotation requirements as particularly burdensome on smaller firms and suggested that smaller firms might need to form partnerships with other firms to meet this requirement. Public accountants were sensitive to the need for caution regarding the overdependence of a firm on a single client, which might exercise undue influence on professional staff. The quality of audit and attest services was viewed as important, with the proper training of professional staff in both concepts and procedures paramount. Ethics training and ethical behavior were specifically cited as potential or actual influences on audit quality. Last, public accountants believed that individual CPAs should not lose incentive income for withdrawing from a high-risk client. No disincentive should exist for refusing to serve a client that poses an inordinate risk.

CPAs from the business-and-management group stressed the importance of a company-wide policy of ethical conduct that is adopted by the board of directors. The board itself should be composed of independent directors. An independent and competent audit committee must be accessible to the independent auditor and the internal auditors. The audit committee should establish clear guidelines as to other services that may be provided by the auditor.

Educators recognized the need to stress independence in fact rather than just appearance. Students should be aware of situations in which a company under audit might exert influence that could compromise independence. Students should also be aware of the dangers of overdependence on a single client. Ethical considerations must be integrated into all courses, at all levels of the curriculum.

CPAs from government entities suggested that policies such as partner rotation and second partner review should be established in order to encourage accounting firm independence.

**Audit process.** How can auditors improve the audit process? Public accountants emphasized the importance

of a written statement of scope of services and the need for direct communication with the audit committee, without management present. CPAs in business, management, and government agreed on the issue of audit scope; those in business and management added that the audit scope must meet stakeholder needs. Public accountants expressed a need for client risk assessment and compensation policies regarding the decision to no longer serve a client. The need for risk assessment of services provided was stressed as well. Public accountants emphasized the need for relevant CPE and for participation in the process of educating new accountants. Educators also supported the participation of public accountants in the education process as a way to bring practical issues into the classroom. Educators further stressed the need for faculty to participate through internships with accounting firms and other entities.

Public accountants stressed the importance of remaining current with new standards and practices. Public accountants must be committed to their audit practices. As part of this commitment, public accountants should help clients improve their financial reporting.

All groups agreed that additional emphasis and training should be given to fraud detection. CPAs in government expressed a need for evidence that CPA firms bidding on governmental audits complied with policies and procedures relating to ethical behavior. Educators emphasized the need for ethical issues to permeate the curriculum. All groups agreed on the need for increased attention to internal controls designed to prevent fraud, as well as the need for increased direction from standards-setting bodies.

All groups recognized the need for a better understanding of materiality and its importance, on the part of both auditors and auditees. Public accountants thought that standards-setting bodies should do more to clarify materiality.

Risk management was also on the minds of conference participants. Public accountants believed that client acceptance-and-retention policies are essential. Criteria must be established to evaluate risk, and clients presenting unacceptable levels of

risk should be dropped. CPAs in business and management should implement procedures to reduce risk. These procedures should cover fraud detection and the separation of duties.

*Technical standards.* All groups stressed the ongoing need for CPAs in all areas to participate in the standards-setting process. The "cascade effect" is real. The inapplicability of SOA standards to nonpublic entities must be recognized and communicated. The same process of review and communication must be applied to proposed standards, with particular emphasis on specific areas that are not appropriate for nonpublic companies.

Reliable measures of performance that are useful to investors, the capital markets, and managers are much needed. The recent

proliferation of earnings metrics has brought confusion and deception, but also suggests a need for new and more effective measures of performance.

All groups agreed that accounting choices and business strategies should be supported by sound business purposes. Attention should be directed toward substantive improvement of value rather than deceptive practices that create false value.

Finally, all groups emphasized the need to simplify financial statement presentation. Financial reports should provide clear explanations rather than using boilerplate language or, worse yet, avoiding the issue altogether.

*Public perception.* How does the profession regain its reputation for integrity? Public accountants expressed concerns

### EXHIBIT 1 Major Themes Identified by Conference Participants

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<b>LIABILITY</b>	
<b>Regulation</b>	State regulation Standards (FASB, GASB) Peer review What/whom to license How much regulation is too much? Self-policing What is effective regulation?
<b>Reputation and Image</b>	Restore Clarify roles Perception
<b>Expectation Gap</b>	Fees Relationships (internal and external to the profession)
<b>Ethics</b>	Enforcement Core values Ongoing education
<b>IMPACT ON PUBLIC COMPANIES</b>	
<b>Standards</b>	Big and little GAAP Small companies' needs, and the cost
<b>Model</b>	Redefine who we are and what we do



about how much companies understand the nonaudit services they can provide. More needs to be done to inform business and the public about these services and their limitations.

Public accountants also suggested offering tiered services for risk-based fees. For example, a baseline audit could be expanded to include fraud-detection procedures and performance measures. Increases in the level and risk of services would be accompanied by increases in fees.

Public accountants echoed a theme from other discussions: Client retention policies must be in place and must function effectively. Firms should redirect resources consumed in servicing marginal clients to finding and retaining quality, low-risk clients.

CPAs in business and management emphasized the need for ethical behavior from management and finance personnel. The need was expressed for sound business practices, particularly in financial reporting and performance measurement. CPAs in business and management should be leaders in identifying problems and finding solutions.

CPAs in education stressed the need to imbue their students with the core values of the profession: integrity, objectivity, competence, attunement to broad business issues, and lifelong learning. Students must fully understand independence as well as the need to meet stakeholder expectations.

CPAs in government expressed a need to educate more than just students about the meaning, purpose, use, and limitations of financial reporting. They also agreed with the other groups that the profession must address the expectations gap and meet the demands of the marketplace. All groups agreed that CPAs must be willing to stand up and do the right thing. CPAs should know what is right and should have the moral courage to do what is right.

**Professional ethics.** CPA licensure requires the completion of the Uniform CPA Examination, which gives limited consideration to ethical problems or dilemmas. Some states require candidates to pass the AICPA Ethics Self-Study Examination, which tests the candidate's basic knowledge of the code of professional conduct but does not test its applications in complex ethical issues. As a

result, candidates are often poorly prepared for ethical challenges.

Surveys have revealed that cheating at every age and in every aspect of life has become the modus operandi for many people in the United States. Our capital markets are built on trust, particularly on trusting audited financial statements. Lack of reliable information has thrown stock markets into chaos. Cheating is incompatible with our market system.

Public accountants encouraged firms to establish a code of conduct and then develop policies (including compensation policies) consistent with the code. Firm management should regularly discuss appropriate professional conduct, for example, at staff meetings. Additionally, auditors should make companies aware of the firm's ethical standards and its resolve to adhere to those standards.

CPAs in business and management as well as in government also stressed the need for a code of conduct, not only for the enterprise generally but for the finance function specifically. Like public accountants, CPAs in business, management, and government believe that appropriate professional conduct should be discussed regularly. CPAs in business and management also suggested that finance and accounting policies focus on the long-term business purpose rather than on short-term gains.

Educators recognized the need for more integration of ethical issues in the curriculum. A major issue for educators is the availability of case material to serve as a basis for class discussions. Educators proposed a partnership with professional organizations to develop current, relevant instructional materials. All groups agreed that each individual must choose the "public good" over personal enrichment.

**Regulation.** Early in the conference it became evident that many CPAs are not well informed regarding the state laws and rules regulating the profession. Many CPAs believe regulation is not working, although they have no idea how the regulatory process works or how it could be improved.

A major problem with accounting regulation in Utah is that no referral program exists for informing regulatory authorities about alleged misconduct. Although a CPA might be aware of misconduct, many fed-

eral and state tax laws, AICPA standards of professional conduct, and client privacy issues prohibit referral of the alleged misconduct. CPAs are hesitant to ask clients to make referrals of misconduct by other CPAs.

Conference participants expressed a need for a system that allows misconduct to be reported without placing the informant in violation of professional, ethical, or legal duties, but could not suggest how such a system would be designed.

**Regulation of the profession.** The major theme of participants' comments about self-regulation was involvement. All groups expressed the need to be involved in professional groups and report violations of professional and ethical standards. Many states require periodic training in ethics and professional conduct. Educators suggested developing a database of ethics case studies from actual incidents in public, private, and governmental accounting. These case studies could be used in training students as well as in continuing professional education.

**Image and reputation.** The gap between what the public expects of CPAs and what CPAs actually can do has been widening for the last 40 years. The public has expected the independent audit to detect fraud; CPAs can provide no such assurance. The public expects CPAs to maintain the same standards of independence and objectivity associated with an audit when performing other services. The only people more confused about the role of CPAs than the public are CPAs themselves.

An increasingly competitive environment has created a perceived need for public accounting firms to provide a broad range of services to clients. "Public accounting" firms became "professional service" firms, providing everything from bookkeeping to human resource management to manufacturing systems. Consulting fee revenues grew exponentially, while audit fees stagnated. The audit became a commodity (and was marketed as such) and was simply a means of gaining access in order to sell lucrative consulting services.

As dependence on consulting services revenues grew, CPAs found it increasingly difficult to maintain independence and objectivity toward audit clients that were also consulting clients. The temptation to compromise was overwhelming.

The revelation of major accounting scandals caused the federal government to order the profession to cease providing audit clients with services that compromised auditor independence and objectivity. The cost to the profession has been monumental.

A major recommendation made by participants from all segments of the profession was to clarify the scope of services to be performed. Engagement letters should clearly specify the procedures to be performed. Public accountants should be proactive in highlighting the scope of services of an engagement, the risks avoided, and the benefits derived from stressing clarity and integrity in financial reporting. Many participants felt that clarity in financial reporting will come only through the development of a new financial reporting model.

Public accountants suggested that one's capabilities should be weighed against

each prospective engagement. Quality-control systems should be enhanced to address the effects of SOA and related rules. Staff should regularly be reminded of the firm's commitment to integrity and quality.

Participants in all segments encouraged a more active education of the public about what the profession does. CPAs should be proud of what they do, and remind the public of the honesty and integrity of the vast majority of CPAs. Everyone also recognized that no amount of public relations activity is a substitute for individual integrity.

### A Call to Action

The conference and the resulting white paper represent a call to action for CPAs in Utah. Other states are welcome to use this same approach as a way to identify issues and to plan actions to be taken to restore public confidence in the

profession. The full text of the white paper can be found at [www.uacpa.org/members/pdfs/stand\\_up\\_and\\_do\\_the\\_right\\_thing.pdf](http://www.uacpa.org/members/pdfs/stand_up_and_do_the_right_thing.pdf).

Response to the white paper has been very positive. Many Utah CPAs who had heard about the forthcoming white paper expected a litany of apologies and excuses. Instead, they have found a document that outlines a plan of action to successfully deal with the challenges that confront the profession now and in the future. □

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## EXHIBIT 2

### Actions That Would Represent Real Breakthroughs

#### ■ Sole Practitioners

- Relevant, understandable GAAP that applies to small enterprises.
- Clarify standards that differentiate services such as audit and compilation.
- Reinforce the positive image of the profession

#### ■ Local Firms

- Create a UACPA ethics committee that will develop comprehensive guidelines and materials for ethics training (CPE), in-firm training, and training at the university level, including a database of cases and examples.
- Speed up the investigatory process. Mandatory ethics education. Implement the concept of a Quality-Control Inquiry Committee (QCIC) in the UACPA.
- Refocus on core values: Integrity, independence, trust, education, conservatism, and being an advocate for the client.
- Image is everything.

#### ■ National Firms

- Resolving the accounting business model, including fee and relationships issues, scope of work, tiered pricing and services, and fair fees for work performed.
- Ensure that the audit is no longer a commodity. Recruit new employees who adhere to the core values of the profession.

#### ■ Members in Business and Management

- Redesign the disciplinary process in Utah through legal changes.
- Root out the bad CPAs.
- Clarify the impact of Sarbanes-Oxley on public companies and speak out on issues that are harmful or that infringe on nonpublic companies.

#### ■ Members in Government

- Resolve the independence issues of management perspective versus the public need.

#### ■ Members in Education

- Define and recommit to our core values of ethics and honesty, objectivity, and independence in fact; adjust the audit process to meet the statement user's expectations to detect fraud. Each of these issues is fundamental to the capital markets, the efficient functioning of which is built on trust.