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FINANCE AND ACCOUNTING OUTSOURCING: THREE STUDIES RELATED TO THE
ETHICAL AND ECONOMIC DIMENSIONS OF ACCOUNTING OUTSOURCING

by

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A dissertation submitted in partial fulfillment of the requirements
for the degree of Doctor of Philosophy
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in the College of Business Administration
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Orlando, Florida

Fall Term
2007

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ABSTRACT

This dissertation evaluates the economic and ethical considerations underlying the outsourcing of professional services such as finance and accounting. The dissertation is comprised of three separate, but related studies. The first study explores the adequacy of the disclosure rules recommended in the revised ethics rulings regarding disclosure of outsourcing relationships and the resulting ethical and economic repercussions for both, the AICPA members and their clients. The second study analyzes the disclosure rules recommended in the AICPA ethics rulings regarding disclosure of outsourcing relationships from an ethical standpoint. The third study adopts the perspective of the third party service provider. The third study analyzes the factors that provide a competitive advantage to leading service providers in accounting outsourcing markets in India. Taken together, these studies address issues that have not been addressed previously in accounting literature and will advance our understanding of a fast-growing phenomenon, the outsourcing of accounting services. Finance and accounting outsourcing may strongly influence the choice of future organizational form and structure thus making it important to develop an early understanding of this industry.

ACKNOWLEDGMENTS

I feel the deepest gratitude and have the greatest regard for my dissertation chair who is also my role model, Dr. Robin Roberts. My PhD endeavor has been one of the most rewarding experiences of my life and without the support and encouragement and constant guidance Robin provided me with, I would not have been able to complete my PhD. He is supportive, nurturing, kind, generous, knowledgeable, a great teacher, the best mentor and one of my dearest friends.

I also wanted to thank my committee member, John Sweeney, providing me with extensive feedback to improve the quality of my dissertation and for his support and encouragement. I am also thankful to Peggy Dwyer and Jim Courtney for providing me with insightful comments to constantly improve this dissertation.

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CHAPTER ONE: GENERAL INTRODUCTION

This dissertation evaluates the economic and ethical considerations underlying the outsourcing of professional services such as finance and accounting. The dissertation is comprised of three separate, but related studies.

Study One:

An Experimental Investigation of the impact of the AICPA Ethics Rulings regarding disclosure of outsourcing relationships with third party providers

The first study explores the adequacy of the disclosure rules recommended in the revised ethics rulings regarding disclosure of outsourcing relationships and the resulting ethical and economic repercussions for both, the AICPA members and their clients. The study examines the behavior of the clients of CPA firms that are outsourcing returns within the realm of the contract entered into for tax return preparation and analyze the repercussions of two contractual issues, disclosure and pricing on both contracting parties. Specifically, this study presents direct evidence using experiments, about how individual taxpayers might react to disclosures made by tax preparers regarding their outsourcing relationships with third party service providers. The primary issues addressed in this study are: members' responsibilities to their clients, the scope of their contract and the resulting contracting problems; and members' motivations to conceal privately held information suggesting opportunistic behavior by AICPA members. The study brings forth important public policy implications for protection of consumers who constitute the most vulnerable targets with regard to the detrimental effects of offshoring. The findings of this study may lead regulators to review the adequacy of the disclosure rules and may induce the recommendation of changes.

Study Two:

The Commercialization Project: The AICPA rhetoric surrounding the tax return preparation outsourcing disclosure rules

The second study analyzes the disclosure rules recommended in the AICPA ethics rulings regarding disclosure of outsourcing relationships from an ethical standpoint. The purpose of this analysis is to study the commercialization of the accounting profession using Giddens (1990) theory of trust and expert systems and Parker's (1994) private interest model in the context of the AICPA's revised ethics rulings regarding the disclosure of outsourcing of tax return preparation. Specifically, I intend to explore the mechanics and the rhetoric employed by the AICPA to revise the ethics rulings (No.112, No.12, and No.1). The primary issues addressed in this study are: members' motivation to avoid full disclosure in order to further their private interests to preserve their socio-economic status with the use of the code of ethics as an instrument that aids promotion of members' private interests; public confidence in the accounting profession and possible impairment of trust; and the commercialistic outlook of the profession and heightened concern with being more profitable. The paper attempts to enforce the view that professional change is a diffuse political process addressing multiple potential constituencies and not necessary, evolutionary, or motiveless.

Study Three:

Sustaining competitive advantage in Finance and Accounting outsourcing markets: A case study of leading third party service providers

The first two studies approach the issue of accounting services outsourcing from the perspective of the outsourcer, whereas, the third study adopts the perspective of the third party service provider. The third study analyzes the factors that provide a competitive advantage to leading service providers in accounting outsourcing markets in India. I develop a theoretical model that examines the factors that enable service providers to maintain market share, by recognizing the issues that endanger

the survival of finance and accounting outsourcing and by developing competencies to address these issues. In doing so, I examine issues that have received little prior theoretical or empirical attention. The method adopted in my study is theory generation in the manner written by Glaser and Strauss (1967), Mintzberg (1979) and Miles and Huberman (1984) based on case study evidence of three leading FAO service providers in India.

Overall Contribution

Taken together, these studies address issues that have not been addressed previously in accounting literature and will advance our understanding of a fast-growing phenomenon, the outsourcing of accounting services. Finance and accounting outsourcing may strongly influence the choice of future organizational form and structure thus making it important to develop an early understanding of this industry. The remainder of this dissertation presents each of the three studies in detail.

CHAPTER TWO: STUDY ONE: AN EXPERIMENTAL INVESTIGATION OF THE IMPACT OF THE AICPA ETHICS RULINGS REGARDING DISCLOSURES OF OUTSOURCING RELATIONSHIPS WITH THIRD PARTY SERVICE PROVIDERS

Introduction

Recently, members of the U.S. Congress, the media, and state and federal regulators have debated a number of issues regarding the responsibilities of businesses to disclose to their customers and clients when they outsource services or production to other countries (AICPA, 2004b). As a result, the AICPA Professional Ethics Executive committee (hereafter PEEC) began a project to assess whether or not the AICPA Code of Professional Conduct (the “Code”) sufficiently addresses the members’ obligations when outsourcing services to third party service providers (hereafter TPSP) (AICPA 2004b). The PEEC examined the effect that outsourcing of accounting and tax services has on integrity, objectivity, compliance with standards and confidential client information, and issued an Exposure Draft in early 2004.

The PEEC received 49 comment letters to that Exposure Draft. Some minor modifications were made to the Exposure Draft based on the feedback received and the final ethics rulings were issued on October 28, 2004. The new pronouncements took effect for all professional services performed on or after July 1, 2005¹. The new requirements (Ethics Ruling No. 112 under Rule 102, Ethics Ruling No. 12 under Rule 201 and 202 and Ethics Ruling No.1 under Rule 301) state that if the member intends to use the services of a TPSP, the client should be informed and be given the opportunity to ask questions concerning the use of the service provider. Additionally, members must enter into contractual agreements with any TPSP to maintain confidentiality of the clients’ information (See Appendix A).

¹ They do not apply to professional services that are performed pursuant to agreements that are in existence on June 30, 2005 that are completed by December 31, 2005.

Previously, the AICPA Code of Professional Conduct (the Code) did not require disclosure to the client when a TPSP is used, whether domestically or overseas (AICPA, 2004b). In determining whether the Code was sufficient or needed to be amended, the PEEC considered a number of ethical issues concerning the use of TPSPs, including whether a new ethics ruling under Rule 102 – Integrity and Objectivity, should be issued to require that, prior to disclosing confidential client information to a TPSP, a member should inform the client that he or she plans to use a TPSP in providing professional services to the client (AICPA, 2004b). The revision of the ethics rulings pursuant to the issuance of the exposure draft seems to reinforce the AICPA’s agreement with the stance that it is their responsibility to disclose to their clients when they outsource services to other providers domestically or to providers in other countries. However, the revised rulings in their current format may not be able accomplish this stated objective due to ambiguous phrasing.

The lack of specificity is indicated by the lack of differentiation made in the revised rulings between outsourcing domestically and outsourcing overseas, also known as offshoring². With the current disclosure requirement, the clients of the firm are informed that a TPSP *may* prepare the returns. It is not necessary to inform the client of the geographical location of the TPSP. The TPSP may be within the US or the return may be offshored to a remote location such as India (AICPA, 2004a). This can be considered a significant area of concern because there are ethical and economic considerations involved in offshoring of professional services such as tax return preparation that are distinctly different from outsourcing returns within the US (FDIC, 2004; GAO, 2005). A number of studies have confirmed that the level of risk is elevated when the third party provider resides overseas. The Federal Deposit Insurance Corporation (FDIC) conducted a study with regard to the associated risks of offshoring by financial institutions from a safety and soundness perspective and with particular

² Outsourcing of returns involves partnering with a service provider located within the US whereas offshoring of tax return preparation involves partnering with an outsourcing facilitator situated overseas.

emphasis on the threats posed to customer privacy in June 2004. Their findings recommended disclosure of undisclosed third-party contracting arrangements since they may increase risk in outsourcing relationships. This potential increase in risk occurs regardless of whether the undisclosed third party resides domestically or offshore; however, inherent outsourcing risks may be amplified due to unique country risk when the third party is an offshore vendor.

Aron et al. (2005) conducted a study that summarizes the risks associated with outsourcing, domestically and overseas. They concluded that there are certain risks associated with outsourcing domestically such as strategic risks (caused by deliberate activities of vendors to exploit clients as part of a profit-maximizing strategy), operational risks (that may arise due to a breakdown in operations at the vendor location) and long-term intrinsic risks of atrophy (with the passage of time, an activity that is outsourced in its entirety may cause the company to lose the core group of people who were familiar with the activity). In addition to all of the above risks of outsourcing domestically, offshoring involves additional risks. These are intrinsic risks of location, caused simply by moving activities to remote locations. Some of these are geopolitical risks; for example, moving activities to India creates an exposure to the potential of violent escalation of conflict between India and Pakistan. The other forms of intrinsic risk of location are equally familiar, such as sovereign risk or exchange-rate risk (Aron et al., 2005).

In addition to the above mentioned general risks of offshoring, offshoring risks that are specific to tax return preparation are the competence of the preparers and the protection of information sent outside the immediate control of the CPA firm. Arguably, CPA firms may have adopted measures to ensure that preparers are competent and client information is protected thereby ensuring that clients' interests are protected no less than if the CPA firm had prepared the return in-house. However, the focus of this study is not whether offshoring of tax returns is more risky than outsourcing domestically

or whether the CPA firms have adequately managed the additional risks that arise from offshoring. The focus of this study is whether disclosure which is made to the clients regarding offshoring of their returns is adequate. Ethics dictate that clients of the tax firms should be provided with disclosures that are adequate enough to make an informed decision about whether their returns should be prepared in-house or outsourced domestically or offshored, based on their own assessment of the risks involved in each scenario.

The reasons underlying clients' decision regarding whether or not to favor outsourcing or offshoring may vary. Clients may have different perceptions about information security and privacy risks and may have different attitudes towards risk. Further, clients may be more opposed to offshoring of returns due to patriotic concerns (Robertson et al., 2004). The wrenching events of recent years have intensified patriotism throughout the United States and many U.S. workers have lost jobs to cheaper third-world labor (Shamis et al., 2005). Other concerns about offshoring are the privacy and security risk of posting confidential client information to an overseas facilitator's website. Most taxpayers do not want their sensitive tax return information ever made public (Soled, 2005).

On the other hand, some clients may favor lower fees that may be offered as a result of the lower expenses incurred by the firms when returns are outsourced or offshored. One of the greatest motivations for the CPA firms to outsource preparation of tax returns, domestically or overseas, is cost arbitrage (Lombardo 2003). The ability to reduce expenses through reduced staff, whether full-time or temporary is an advantage that is common to both outsourcing and offshoring of services. The tax preparers may pass on a portion of these cost savings to their clients in the form of reduced fees which may be lucrative to clients who value cost savings. In case of offshoring of returns there are some added benefits over and above outsourcing such as the practical efficiency afforded by an overseas workforce coupled with the advent of technology that enables speedy data transfer. The time-zone

differences create virtual twenty four hour operations since the daily close of operation in the U.S. accounting firms is marked by the start of the work day for overseas accountants. Thus, offshoring can improve client service by speeding the delivery of completed returns (Robertson et al. 2004).

In conclusion, it should be the client's prerogative to make the decision about whether their return should be outsourced, offshored or prepared in-house, given all the relevant information and after they weight the costs and benefits involved. The AICPA's decision to offshore returns without client consent could be an attempt to use their expertise to make decisions in lieu of their clients who may not possess, in the AICPA's opinion, the knowledge, expertise or requisite information to make their own decisions (Dwyer and Roberts, 1998). The purpose of this study is to explore the adequacy of the disclosure recommended in the revised ethics rulings and the resulting ethical and economic repercussions for both, the AICPA members and their clients. I examine the behavior of the clients of CPA firms that are outsourcing returns within the realm of the contract entered into for tax return preparation and analyze the repercussions of two contractual issues, disclosure and pricing on both contracting parties. Specifically, this study presents direct evidence using experiments, about how individual taxpayers might react to disclosures made by tax preparers regarding their outsourcing relationships with TPSPs. I build my hypotheses using the theory of social contracts (Oosterhout et al., 2006) and search theory of economic rationality (Stigler, 1961) to analyze the reaction of individual taxpayers to the disclosure strategy and the pricing strategy adopted by the tax preparers.

The primary issues addressed in this study are: members' responsibilities to their clients, the scope of their contract and the resulting contracting problems; and members' motivations to conceal privately held information suggesting opportunistic behavior by AICPA members. This study is important for several reasons. First, it contributes to the contractualist business ethics literature by empirically testing the Oosterhout et al. (2006) contract model in the tax return offshoring setting. Second, it uses social

contract theory to understand the contract between taxpayers and tax preparers. Thus far the notion of social contract has been explored in tax research in relation to tax compliance and tax evasion (Brennan and Buchanan, 1980; Frank, 1993 and Vihanto, 2003). This stream of research is centered on the contract between the governments, which serves as the agent liable for enforcing the tax rules and entitled to use force toward this end, and the taxpayer. The contractual issues between the tax preparers and the taxpayers are at the forefront of the offshoring practice and an investigation into the finer nuances of this relationship will problematize the disclosure strategy adopted by the tax preparers, i.e., the AICPA members. Third, it identifies economic motivation for the AICPA members not to voluntarily disclose information about offshoring tax returns. By doing so, the study brings forth important public policy implications for protection of consumers who constitute the most vulnerable targets with regard to the detrimental effects of offshoring. The findings of this study may lead regulators to review the adequacy of the disclosure rules and may induce the recommendation of changes.

The paper proceeds as follows. The next section provides a background of the outsourcing and offshoring phenomenon and the shortcomings identified in the revised AICPA ethics rulings. Section 3 describes the Oosterhout et al. (2006) theory of social contracts and Stigler's search theory of economic rationality followed by development of testable hypotheses. Section 4 details the experimental methods. The analysis of results will be presented in Section 5. The paper will conclude with a discussion and conclusion in Section 6.

Background

The succeeding discussion provides a background of the practice of outsourcing and offshoring and elaborates on the distinction between outsourcing domestically versus offshoring of tax returns. This background highlights the reasoning behind disclosure. This discussion is followed by a description of

the varied concerns brought forth by the revised ethics rulings and their inability to address the key concerns of disclosure of confidential client information to bring forth possible shortcomings of the revised rulings in their current format.

Outsourcing and Offshoring: Pros and Cons

Dun & Bradstreet estimates that outsourcing, a practice that commenced approximately thirty years ago, has grown exponentially, and generating revenues up to \$4 trillion a year (Fortune, 2005). A survey of Outsourcing World Summit attendees established that outsourcing of finance, accounting, sales, tax and marketing services is presently taking precedence over IT, manufacturing, and real-estate facilities services, which were traditionally, the most outsourced functions (Fortune, 2005). The ascension of the number of companies that adopt outsourcing as a mode of cutting costs in order to focus on core competencies has led to a consequent ramping up of proposed U.S. state and federal laws to limit outsourcing and offshoring (Hrivnak, 2005). Outsourcing and offshoring of professional services have raised ethical questions regarding integrity, objectivity, disclosure, and client confidentiality (Mintz, 2004). Tax return preparation is recognized as, perhaps, the predominant product of outsourcing to date (Cook et al. 2005). Professional services such as tax return preparation have been offshored to foreign locations such as India amid concerns regarding confidentiality and security of confidential client information (McGee, 2005).

Outsourcing of returns involves partnering with a service provider located within the US whereas offshoring of tax return preparation involves partnering with an outsourcing facilitator situated overseasⁱ. The pros and cons of the outsourcing practice are discussed below. The proponents of outsourcing of tax compliance work explicate a number of reasons for the popularity of the practice (McGee, 2005). For example, outsourcing can disengage accounting professionals from devoting time to routine tasks to offering an extended orbit of client services, minimize the burden of recruiting

professionals, promote cost economies, and accelerate the delivery of client returns (Robertson et al., 2004). Alternately, there are concerns that outsourcing limits the tax preparation experience of entry-level accountants and may be lead to decreased staff morale due to staff concerns about layoffs (Robertson et al. 2004). Further, technology capability may act as a deterrent to effective outsourcing because firms are required to have technology capabilities, including hardware, data storage, software, and knowledgeable people, to move manual processing to a web-based processing system.

Offshoring of tax returns encompasses not only the pros and cons of outsourcing but other unique costs and benefits as well. Offshoring offers further benefits such as alleviation of temporary shortages of available tax professionals in the US (eAccounting, 2004). Critics of offshoring claim that one of the greatest concerns about offshoring is the privacy and security risk of posting confidential client information such as social security numbers to an overseas facilitator's website (Robertson et al., 2004). However, some AICPA members argue that the concerns regarding the security and confidentiality of data are unfounded. They insist that reputable TPSPs institute security measures that far exceed the measures applied by numerous accounting firms within the U.S. (AICPA 2004c) The production facilities operate in an altogether paperless environment and admission of any kind of stationary or personal effects, such as purses and brief cases, into the production area is prohibited. Further, lack of removable media devices on staff computers, restrictions on storing of client data on the hard drive, lack of email capability, instant messaging capabilities, restricted access to the internet and Non-Disclosure agreements greatly minimize the risk of data tampering and identity theft (Appendix MM, AICPA, 2004b).

Regardless, there may be clients who do not condone the transmission of their confidential information to a third party who is not directly supervised by their CPA. U.S. laws that protect information and safeguard privacy do not have extra-territorial application resulting in the U.S.

government, corporations and U.S. citizens becoming increasingly dependent on foreign laws to protect their interests (IEEE, 2004)³. The risk posed to these interests by individuals and organizations who would take advantage of weak laws, loopholes and limited access to enforcement is not insignificant (IEEE, 2004). Other concerns are political instability in the country of the service providing company which may lead to interruptions in processing operations.

Finally, clients of the tax firms may have patriotic concerns about the offshoring of tax preparation work (Robertson et al., 2004). The wrenching events of recent years have intensified patriotism throughout the United States and many U.S. workers have lost jobs to cheaper third-world labor. Clients may view offshoring as yet another myopic approach that needlessly diminishes the U.S. job market (Shamis et al., 2005). The results of a survey, conducted to gather evidence on taxpayers' perceptions concerning public accountants' disclosure of tax return preparation outsourcing, indicate that greater than 84% of the respondents, who availed the services of a tax-preparer, considered offshoring of their returns to be a significant cause for concern (Brody et al., 2006). The above discussion reinforces my argument that offshoring of returns raises concerns that are distinct from outsourcing domestically. It imbeds a degree of skepticism into the AICPA's claims that the taxpayers are indifferent between outsourcing and offshoring of their tax returns (AICPA, 2004b).

Ethics Rulings under AICPA's Rule 102 and Rule 201, 202 and 301: Shortcomings in the disclosure rules.

The revised AICPA ethics rulings contain provisions that may provide different interpretations to different readers. The inadequacies in the rulings are instrumental in the germination of the contracting problems that arise subsequently. Contracting problems may frustrate the expectations of contracting parties inducing them to end the contract. Therefore, gaining an understanding of the shortcomings in

³ The IEEE, a non-profit organization, is the world's leading professional association for the advancement of technology and stands for Institute of Electrical and Electronics Engineers, Inc.

the rulings may be an important step towards reducing informational asymmetry between the client and the AICPA member. The shortcomings identified in each of the revised rulings are discussed below.

Rule 102 - Integrity and Objectivity: Ethics Ruling No. 112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services

Rule 102, ET 112 (See Appendix A) was issued to provide guidance with respect to a member's responsibilities when using TPSPs to provide professional services to clients. The new requirements mandate that AICPA members must inform clients, preferably in writing, when they use TPSPs to provide professional services such as outsourced bookkeeping, tax-return preparation, consulting and attestation services excluding administrative support services (AICPA 2004a). An analysis of the comment letters brought forth the criticisms forwarded by some of the AICPA members against the rulings in their current format. The Professional Conduct Committee of the California Society of Certified Public Accountants criticized the method of disclosure which leaves the form of disclosure to the member's discretionⁱⁱ. The method of disclosure should require mandatory disclosure in a written form that is acknowledged by the client (Appendix HH, AICPA 2004b).

The disclosure should include the geographic location of the TPSP without specifically revealing the identity of the third party. (Appendix HH, AICPA 2004b). A contractual agreement with a foreign entity such as a firm based in India may be difficult to enforce as a practical matter. Therefore, disclosure of confidential information to a foreign entity should be required to be disclosed to a client. Another criticism of the ruling was forwarded by the Information Technology Executive Committee pronouncing that the rule does not describe what a TPSP "is"; it describes what it "is not." (Appendix QQ, AICPA 2004c). Also, the format of the current disclosure allows the disclosure to be made as a part of documents such as a tax organizer or in the standard privacy policy letters thereby reducing its accessibility to the taxpayers.

Rule 201—General Standards and Rule 202—Compliance with Standards ET 12. Applicability of General and Technical Standards When Using a Third-Party Service Provider

Rule 201 and Rule 202, ET 12 (See Appendix A) specify the responsibility an AICPA member in public practice has for complying with general and technical standards when using a TPSP to provide professional services. The rules specify that members remain responsible for providing adequate oversight for all services performed by TPSPs and they must adequately plan and supervise such services and obtain sufficient relevant data to support the work product. One of the shortcomings of this ruling was underscored by the Accounting Principles and Auditing Standards Committee of the Florida Institute of CPAs. Though the committee agreed that the member should assume responsibility it elaborated the difficulty of operationalizing the assumption of responsibility.

In asking a member to be responsible for the “adequate oversight of all services performed by the TPSP and for ensuring that all professional services are performed with professional competence and due professional care” it appears that the AICPA expects the TPSP to adhere to the standards that the member is bound by in regard to ethics (Appendix EE, AICPA 2004b). The California Board of Accountancy criticized the ruling by arguing that it is important to emphasize the member’s direct responsibility for safeguarding outsourced client information because of the potential for identity theft and other financial fraud that could be committed once documents are sent to TPSPs. (Appendix FF, AICPA 2004b).

Rule 301 - Confidential Client Information ET 1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member

Rule 301, ET 1 (See Appendix A) states that a member should enter into a contractual agreement with the TPSP to maintain the confidentiality of the client’s information, and should use reasonable care to determine that the third-party has appropriate procedures in place to prevent unauthorized

release of confidential client information to others. These provisions are challenging for several reasons that are brought forth in the following arguments. The members of Information Technology Executive Committee argued that members may lack the technical competence to review the procedures in place to prevent unauthorized release of confidential client information, and moreover, most TPSPs would not allow their procedures to be reviewed, as that would be considered a breach of best practices. (Appendix QQ, AICPA 2004b).

The Texas State Board of Public Accountancy believes that a confidentiality agreement with a TPSP is not an adequate substitute for client consent when services are to be rendered by the TPSP and that provider is outside of the jurisdiction of the United States legal system. Further, the board recommends requiring a confidentiality agreement between the member or member's firm and an administrative support TPSP when that provider would have access to confidential client information, since there is no required disclosure of such arrangements to the client. (Appendix RR, AICPA 2004b). Thus, the AICPA may be free riding on claims of professional care, responsibility, and due diligence by passing on the responsibility to the TPSPs and may be taking advantage of the information asymmetries that exist due to the inability of the clients to monitor their activities.

Hypotheses Development

In this study, I use both economic-based and sociology-based theories to develop three sets of hypotheses. The first set of hypotheses provides taxpayers' reactions to the disclosure strategy adopted by the AICPA member. The second hypothesis provides taxpayers' reactions to the pricing strategy adopted by the AICPA member. The third hypothesis addresses the possibility of an interaction between the disclosure strategy and pricing strategy on the reactions of taxpayers. The theory of social contracts (Oosterhout et al., 2006) provides the theoretical understanding underlying the first set of

hypotheses and drives the disclosure strategy variable. Donaldson and Dunfee (1999) have argued that the rules of business ethics should be based on norms determined by communities since communities, geographic or other reference groups determine what is appropriate. In the context of the ethical norms related to the conduct of AICPA members, the ‘community’ involves any combination of stakeholders such as clients, the business community, and regulators. The focus of this study is the AICPA members and how their code of ethics should reflect responsibilities to a particular set of stakeholders, their clients.

Hypothesis 1: Taxpayers’ response to firm disclosure strategy

Social contract theory is grounded in the appealing idea that human interaction and association should be guided and constrained only by those norms and institutions that freely consenting agents could and possibly would agree to if they had the choice (Hampton, 1993). Oosterhout et al. (2006) direct our attention to two behavioral assumptions that economic organization theory has identified as highly relevant in the context of contracting (Williamson, 1985). The first is that contractors may sometimes be subject to overly self-regarding or opportunistic tendencies that lead them to exploit the freedom they enjoy in moral free space by unjust means (Williamson, 1985). The second is that contractors are subject to bounded rationality (Simon, 1955, 1998) or cognitive limitations that interfere with their ability to rationally devise norm-generating contracts within moral free space. They confront these two behavioral assumptions with two normative expectations guiding all contractual relations, reciprocity and effectiveness.

This produces an idealized set of four contracting problems representing their version of the state of nature: the predicament in which contractors find themselves when there is no internal morality of contracting in place to guide and constrain their behavior. The four general contracting problems that contractors must strive to avoid when engaging in extant contracting practices are desolation,

deception, defeasance, and defection. These problems are studied in context of the current study and three contractual problems existing in the social contract between the AICPA member and the client are identified. Each of these problems corresponds to the contracting problems identified by Oosterhout et al. (2006) and is discussed in detail below. Figure 1 provides the framework to guide the first hypothesis. This figure indicates that the AICPA member-client relationship is indicative of three contracting problems: veiling the identity of the TPSP, Lack of specific client consent, and concealing privately held information. An analysis of contracting problems helps identify the possible motivations underlying the recommended disclosure strategy in the revised ethics rulings.

Table 1. Disclosure (D) Scenarios

	Disclosure in AICPA recommended format	Disclosure that returns are outsourced to an overseas TPSP	Disclosure that returns are outsourced to a domestic TPSP	Disclosure that returns are prepared in-house
	(returns are offshored)	(returns are offshored)	(returns are outsourced)	(returns are not outsourced at all)
Pricing (P) Strategy	D1	D2	D3	D4
Fee Decrease (P1)	Case 1 P1D1	Case 2 P1D2	Case 3 P1D3	Case 4 P1D4
No Change (P2)	Case 5 P2D1	Case 6 P2D2	Case 7 P2D3	Case 8 P2D4

^a Assessment of the likelihood that the taxpayer will return to the same CPA firm the following year for tax return preparation.

Veiling the Identity of the TPSP

The problem of desolation is described as veiling the identity of the TPSP in the tax offshoring scenario and is situated in the upper left hand corner of the Oosterhout et al. (2006) model (See Figure 1). The problem of desolation suggests that that a contract will not come into being unless all parties anticipate some gain from it. Yet the behavioral condition of bounded rationality may limit the ability of potential contractors to envision such gains. In the context of tax return offshoring, the AICPA member will definitely reap economic gains. However, the contractual problem of desolation arises

because the client may perceive offshoring as not beneficial to him or her. The question that arises is why the client believes that offshoring is not beneficial. Before returns were offshored, the client substituted the identity of the AICPA member as a proxy for quality, which guarantees a certain minimal level of performance, since his or her bounded rationality limits his or her knowledge of the quality of tax returns. After returns are offshored, if the identity of the AICPA member is substituted by a TPSP, the client may perceive quality of tax return to be lower. Thus, he or she may want to rescind the contract. To avoid this problem, the member prefers to veil the identity of the TPSP.

The AICPA members fear that once the identity of the TPSP is revealed, the clients will not return to the firm the following year leading to loss of revenue. The primary motivation for adoption of a disclosure strategy by the AICPA member that veils the identity of the TPSP is to maximize the likelihood of clients returning to the CPA firm the following year for tax return preparation. Thus, it is hypothesized that per AICPA members' beliefs, revealing the identity of TPSP will lower the client's likelihood of returning to the CPA firm causing the AICPA to favor the disclosure strategy in the AICPA format which conceals the identity of the TPSP over the strategy of full disclosure that reveals that the returns are being offshored.

Failure to procure Specific Client Consent

The term defeasance indicates the possibility of a contractual scheme becoming maladapted to contractors' interests because of unforeseen contingencies. This happens, for example, when the conditions under which they gave their consent change dramatically while the contract itself provides no provision for such contingencies. Ultimately, the central question is whether a contract is still binding under dramatically changed circumstances. Failure to procure specific client consent characterizes the contracting problem of defeasance in the tax return offshoring setting and is situated in the bottom left hand corner of the Oosterhout et al. (2006) model (See Figure 1). At the time of

entering into the contract for preparation of tax returns, the client has an expectation that the return will be prepared by or under the supervision of the AICPA member. The terms under which consent was given change dramatically when returns are offshored. Procuring specific client consent would diminish the defeasance problem but according to the AICPA member, it may also reduce the effectiveness with which services may be rendered.

The AICPA's reluctance to secure client consent evidences their intention to extend the scope of the contract entered into without solidarity of contracting parties. The AICPA's reluctance to secure specific client consent is revealed in their reaction to the proposed IRS rulings regarding the offshoring of tax returns. The proposed IRS disclosure expressly states that if the tax return preparer is located outside of United States then the taxpayer's written consent will be required prior to offshoring the returns. The logic forwarded by the IRS is that it is difficult to enforce legal action against a provider located outside the US jurisdiction hence the tax payers should be aware of the increased risks faced by them in the event of offshoring. The AICPA's concern is that if the IRS regulation is passed, the clients may not concede to the offshoring decision which will reduce the effectiveness with which the members can provide the service and result in loss of clients who do not approve of offshoring of returns. They discouraged the IRS from passing a regulation requiring disclosure by appealing to arguments of efficiency and simplicity in the filing process. Procuring specific client consent is the second factor that is instrumental in lowering the likelihood of the client returning to the same CPA firm the following year for tax return preparation and hence, the AICPA will favor the disclosure strategy in the AICPA format that conceals information about the offshoring of returns over strategy of full disclosure that discloses offshoring of returns.

Concealing Privately held Information

Reciprocity is also threatened by calculated efforts of some contracting parties to mislead or confuse others (Williamson, 1985). Contractors are vulnerable to partner opportunism as a consequence of ex ante information problems (Akerlof, 1970), a form of information asymmetry whereby one party is better informed about its own motivations and qualifications than other contractors. The term deception is used to denote the contracting problems whereby all deliberate efforts to mislead contracting partners are made before they commit themselves to a binding agreement. The AICPA is guilty of concealing clues that would make it evident to the client that the terms of engagement have been altered. The AICPA's attempt to mislead their clients is revealed by their reluctance to disclose information about the geographical location of the service provider. The PEEC believes that when a client hires a member or his or her firm to perform professional services, the expectation is that the services will be performed by the member or partners or employees of the firm (AICPA, 2004c). Yet, this expectation seems to be subordinated to the appeal of offshoring of tax return preparation which is advantageous to the members.

By concealing information about the risks faced by the clients and equating outsourcing domestically to offshoring, the AICPA members may be making a deliberate attempt to obfuscate their clients before engaging in a binding agreement with them. Concealing privately held information characterizes the contracting problem of deception in the tax return offshoring setting and is situated in the upper right hand corner of the Oosterhout et al. (2006) model (See Figure 1). The problem of deception will be overcome if the AICPA reduces the dysfunctional ex ante information asymmetries so that the opportunity to exploit proprietary information does not result in abusing their commitment to their clients. Concealing privately held information is the third factor instrumental in lowering the client's likelihood of returning to the same CPA firm the following year for tax return preparation

leading the AICPA member to adopt a disclosure strategy in the AICPA format that conceals information regarding the offshoring of return preparation versus the strategy of full disclosure.

The above discussion describes how the three contracting problems conjoin to identify the motivations of the AICPA members not to disclose offshoring information. The AICPA members want to maximize the taxpayer's likelihood of returning to the same firm the following year for tax return preparation because losing repeat customers will hurt their socio-economic interests. The taxpayer's likelihood of returning is hypothesized to be a function of the disclosure strategy adopted by the AICPA member. The AICPA member will react favorably to a disclosure strategy that maximizes the likelihood of returning and will be averse to any disclosures that lower the likelihood of returning. The likelihood of returning is influenced by client's averseness to offshoring of tax returns. The more averse the client is to the practice of offshoring, the greater is the AICPA member's incentive to conceal privately held information about offshoring. Hypothesis 1 tests the main effect of the disclosure strategy factor on the likelihood of returning. Accordingly, the first hypothesis of this study is stated as follows:

Hypothesis 1: The likelihood that taxpayers will return to the CPA firm for tax return preparation is lower when there is disclosure that returns are being offshored than when there is disclosure of outsourcing in the AICPA format

From the above, one can argue that if the returns were prepared in-house, the likelihood of the client returning to the firm the following year would be higher, than if returns were outsourced or offshored. The disclosure strategy that discloses that returns are prepared in-house is a control condition thus facilitating a comparison of the client's response to outsourcing and offshoring of returns.

Hypothesis 1a: The likelihood that taxpayers will return to the CPA firm for tax return preparation is higher when returns are prepared in-house than when there is disclosure that returns are being offshored.

Hypothesis 1b: The likelihood that taxpayers will return to the CPA firm for tax return preparation is higher when returns are prepared in-house than when there is disclosure that returns are being outsourced.

Hypothesis 2: Taxpayer's response to firm pricing strategy

In this section, I appeal to Stigler's search theory of economic rationality in order to understand the taxpayer's behavior in response to pricing strategy. The tax payers are sensitive to the disclosure strategy as well as changes in fees. Given the requisite information, the pricing strategy of the tax preparer will have a bearing on the taxpayer's likelihood of returning to the same firm in the following year. Fishman and Hagerty (2003) analyze a market in which all customers know whether information has been disclosed, but some customers lack the technical expertise necessary to interpret the information, therefore they are categorized as uninformed. This lack of expertise may be due to consumers having neither the time nor the education to become knowledgeable enough to understand the information. In their model, with uninformed customers who cannot observe product quality, pricing decisions of sellers are strategic as well (Fishman and Hagerty, 2003).

When price is better known than quality, consumers may use three choice strategies under uncertainty: best value, price-seeking, and price aversion (Gordon, 2005) Best value is choosing the brand with the least overall cost in terms of price and expected quality; price-seeking is choosing the highest priced brand to maximize expected quality; price aversion is choosing the lowest priced brand to minimize immediate costs. The three choice strategies arise from three different research paradigms: best value from the economic theory of rationality, price-seeking from research on inference, and price aversion from research on risk aversion. Rationality is a set of principles that describe the normatively best or utility maximizing choice.

Stigler (1961) is usually referred to as the first paper in search theory of economic rationality. The typical case considered in search theory is described as follows. A consumer wants to buy a unit of a

certain commodity. Clearly, he prefers to do so at the lowest available price in the market.

Unfortunately, he does not perceive all ruling prices with certainty, and there are costs such as money, time, and disutility attached to actions that improve the perception of his transaction opportunities, i.e., searching for lower prices. Both the returns of search in the form of lower prices and the costs of search will also depend on the consumer's preferences. Economic behavior implies that a consumer does search, and thus does change his perspective on his opportunities, as long as he perceives this to be advantageous to him. As a result, agents do not necessarily buy at the lowest price available in the market, but at the lowest price they perceive in their opportunity set, while better opportunities might be available 'just around the corner'.

In this study, the behavior of the taxpayers in response to the firms' pricing strategies is understood by appealing to the search theory of economic rationality (Stigler, 1961). A rational self-interest maximizing individual will favor lowest price available in the market given a set of opportunities. Thus, it is hypothesized that decrease in fee will be viewed favorably by taxpayers and will increase their propensity to return to the same firm for tax return preparation the following year in all the three cases, outsourcing within the US, offshoring, and returns are prepared in-house, as opposed to no change in fees. Thus, the likelihood of the client returning to the same firm the following year for tax return preparation will be influenced by the pricing strategy adopted by the AICPA member. Reduced fees may signal to the taxpayers that a portion of the cost savings is being passed on to them and may moderate the negative effect of the offshoring disclosure making them less averse to offshoring. Thus, Hypothesis 2 states that likelihood of returning under decreased fees will be significantly higher than likelihood of returning under no change in fees. Accordingly, the second hypothesis of the study is stated as follows:

Hypothesis 2: The likelihood that the customer will return to the CPA firm for tax return preparation the following year is higher when the fee is decreased the following year than when there is no change.

Hypothesis 3: Interaction effect between Pricing strategy and disclosure strategy

An interaction effect between pricing strategy variable and disclosure strategy variable is hypothesized as described in the model below. The specific nature of the interaction, if any, will be examined by conducting post hoc analyses.

Likelihood of returning = Disclosure Strategy * Pricing strategy * (Disclosure strategy*Pricing strategy) where the last term on the right hand side of the equation is the interaction term.

Accordingly hypothesis 3 of the study can be stated as follows:

Hypothesis 3: Pricing strategy moderates the relationship between disclosure strategy and the likelihood that the customer will return to the CPA firm for tax preparation the following year.

Research Methods

The experiment focuses on likelihood judgments made by the taxpayers about returning to the same firm for tax return preparation. One reason for choosing a likelihood judgment task is to capture the reasoning embedded in the taxpayers' response to the disclosure strategy and the pricing strategy adopted by the AICPA member. The results of the experiment will bring forth the concerns that the taxpayers may have regarding offshoring of their tax returns and assess whether the currently revised rulings adequately address those concerns. The disclosure strategy and pricing strategy are the independent variables. The dependent variable is the subject's assessment of the likelihood of returning to the same firm the following year for tax return preparation.

Subjects

Subjects were recruited by students in four undergraduate accounting classes. Students were offered extra credit points for recruiting eligible participants. An eligible participant was described as

an “US citizen over age 18 who has filed tax returns for at least two years”. The participants were seated in an auditorium and were given thirty minutes to complete the questionnaire. The total number of respondents recruited was 258. 10 of the respondents did not pass the manipulation check questions and were eliminated. 5 respondents were eliminated due to incomplete responses leaving a total of 243 respondents. Respondents were asked the following question: “Have you or a family member ever been terminated from a job because your employer outsourced your position to a TPSP”. An affirmative response to the question was presumed to signify the presence of personal prejudice towards outsourcing. 24 respondents gave positive responses to this question and were subsequently eliminated resulting in a final sample of 219 useable responses.

Instrument

The questionnaire required the subjects to make decisions about their likelihood of returning to the same CPA firm the following year for preparation of their tax returns denoted as L(R), based on the pricing strategy and the type of disclosure given to them. The two pricing strategies and four disclosure strategies gave rise to eight versions of the same questionnaire. The questionnaire was prepared in two parts. Part one provided details about the following hypothetical case scenario:

Mckinsey & Pullen LLP is one of United States' largest accounting firms offering a wide range of services such as audit, accounting services, tax return preparation, estate and financial planning. M&P serves clients from approximately 100 offices across the United States. You have been using the services of M&P LLP to prepare your tax returns since 1998. Your adjusted gross income for the recent tax year, 2006, was approximately \$170,000, including \$8,000 of investment income. You have approximately \$18,000 in itemized deductions.

The 2005 tax returns were completed on a timely basis, and you were satisfied with the quality of the services rendered by M&P. In 2005, M&P did not outsource tax return preparation, and all individual tax returns were completed in-house by company employees. M&P charges clients for their services based on the actual billable time spent on their jobs. Billable time includes all preparation work, consultations, research, phone calls, e-mails and a review of the tax preparer’s work. In 2005, M&P sent you an invoice for tax preparation fees and expenses in the amount of \$1,200.

In January 2007, you receive a notice from M&P reminding you of the documentation needed from you in order to prepare your 2006 return. The notice also states that since you are one of their long-term clients, in an attempt to demonstrate to you how much they value your business, you will receive

a discount of 20% of the amount of the total tax return preparation fees that will be charged for the 2006 tax returns.

Versions 1-4 included a price decrease (20%) representing pricing strategy I which was fee decrease. Versions 5-8 did not include any discount on fees representing pricing strategy II which was no change in fees charged from the previous year. Further the case scenario in version 1 included the following paragraph which is the disclosure format recommended by the AICPA when returns are outsourced to a TPSP:

M&P may from time to time, and depending on the circumstances, use third-party service providers in serving your account. M&P may share confidential information about you with these service providers, but will remain committed to maintaining the confidentiality and security of your information. Further, M&P will maintain internal policies, procedures and safeguards to protect the confidentiality of your personal information and will enter into confidentiality agreements with all service providers to maintain the confidentiality of your information. M&P will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that M&P is unable to secure an appropriate confidentiality agreement, you will be asked to provide prior consent to the sharing of your confidential information with the third-party service provider. Furthermore, the firm will remain responsible for the work provided by any such third-party service providers.

The above format discloses that the return will be outsourced to a TPSP but does not reveal the location of the TPSP. The language used in the case was adopted from a sample notification disclosure document released by the AICPA (AICPA, 2005). This disclosure could lead respondents to assume that returns are outsourced or offshored or not outsourced at all. The use of ‘may’ informed them of possibility that returns may be outsourced but at the same time is not conclusive. Since the location of the TPSP is not mentioned, some respondents will make assumptions about whether returns are outsourced domestically or overseas. The response to disclosure strategy I (D1) in version 1 helped gauge the impact of the AICPA recommended disclosure in terms of the other forms of disclosure on the clients.

Respondents were then asked “Please circle below the percentage that most adequately represents the probability that you would continue to retain the services of M&P to prepare your 2006 tax return.

Responses were recorded on a ten point scale with 0% = definitely will not retain and 100% =

definitely will retain. This question served as a dependent variable. The next question probed the reasons for their answer in the previous question. Respondents were asked to list the extent of importance that the factors, fee decrease, confidentiality of data, and quality of tax returns prepared by the tax preparer had, in making their decision. The responses were recorded on a 7 point likert scale with 1 = not very important and 7= very important. They were also asked to list any other reasons that may have influenced their decision-making. Version 2 was identical to version 1 with the exception it included the following statement: “The notice also stated that M&P uses the services of a third party service provider located in India in serving your account”. This statement expressly states the location of the TPSP and intends capturing the respondent’s reaction to disclosure relating to their return being sent overseas and represents disclosure strategy II (D2). In version 3 this statement was substituted by the following statement: “The notice also stated that M&P uses the services of a third party service provider located in US in serving your account”. This statement expressly mentions that the TPSP is located within US and intends to differentiate between the respondent’s reaction to the return being outsourced overseas versus being outsourced domestically and represents disclosure strategy III (D3). Version 4 was a control condition and expressly stated that returns were prepared in-house by the employees of M&P. This statement represents disclosure strategy IV (D4).

Part two of the experiment materials included a post experiment debriefing questionnaire, demographic questionnaire, patriotism scale and risk aversion scale. The post experiment de-briefing questionnaire included questions that directly asked the respondent about their views regarding overseas outsourcing of their returns. They were asked if they believed that outsourcing of their returns would lower the quality of tax return preparation. Further, they were asked to express their agreement with the following statement: “Confidentiality of my personal data will be safe if I use a tax preparer who transfers my tax information, under his or her supervision, to a third party provider located

overseas for completion of my tax return”. Similarly, other statements inquired if they agreed that the preparer should ask for their specific consent when using the services of a third party provider and whether the preparer is behaving unethically when he or she sends their information, without the respondent’s knowledge, to a third party. Further, they were asked if they believed that the fees charged for the return should be decreased when returns are outsourced.

The demographic questionnaire included a question regarding the political ideology of the participant. Other questions explored whether the participant or any family member had been terminated from a job due to the employer outsourcing the position to a TPSP. This question was designed to detect and eliminate respondents that may hold biased views towards outsourcing due to personal prejudices thus skewing validity of the results. Level of patriotism was measured after the experiment is conducted by recording participants’ responses using a CETSCALE (Shimp and Sharma, 1987). The CETSCALE (See Appendix D) is a psychometrically rigorous scale for measuring a concept termed as “consumer ethnocentrism”. “Consumer ethnocentrism” represents the beliefs held by American consumers about the appropriateness, indeed morality, of purchasing foreign-made products. From the perspective of ethnocentric consumers, purchasing imported products is wrong because, in their minds, it hurts the domestic economy, causes losses of jobs, and is plainly unpatriotic. The participants’ attitude towards risk was also measured by using the risk scale component of the Jackson personality inventory measure.

The participant could not refer to part one while answering part two and they were asked to answer part two only after they placed part one back into the envelope. This was done to ensure that their initial responses would not be affected by the questions in the debriefing questionnaire. The eight versions of the case were arranged serially. An equal number of cases were prepared and distributed to

ensure that each of the groups had equal ns. The participants were assigned at random to a particular version.

Analysis of Results

A two-way ANOVA was used to examine H1 through H3. The ANOVA includes the following two factors: (1) disclosure strategy variable with four levels and (2) pricing strategy with two levels. The dependent variable is each individual's likelihood of returning score. The results of the ANOVA are presented in Table 2.

Table 2. Two-way analysis of variance results for client's likelihood of returning to the same CPA firm the following year

Tests of Between subjects effects

Source	Type III Sum of Squares	Df	Mean Square	F	Sig.	Partial Eta Squared	Noncent. Parameter	Observed Power(a)
Corrected Model	34843.405(b)	7	4977.629	8.024	.000	.210	56.171	1.000
Intercept	691053.349	1	691053.349	1114.051	.000	.841	1114.051	1.000
DisclosureStrategyIV	33300.214	3	11100.071	17.894	.000	.203	53.683	1.000
PricingStrategyIV	236.315	1	236.315	.381	.538	.002	.381	.094
DisclosureStrategyIV * PricingStrategyIV	1425.179	3	475.060	.766	.514	.011	2.298	.213
Error	130884.677	211	620.307					
Total	856550.000	219						
Corrected Total	165728.082	218						

a Computed using alpha = .05

b R Squared = .210 (Adjusted R Squared = .184)

Hypothesis 1 (H1) predicts that the likelihood that taxpayers will return to the CPA firm for tax return preparation is lower when there is disclosure that returns are being offshored than when there is disclosure of outsourcing in the AICPA format. Table 2 indicates that the disclosure strategy variable had a statistically significant main effect. A statistically significant difference among the means of the four disclosure strategy levels was found $F(3,211) = 17.894, p < 0.000$. As Table 3 indicates, the mean likelihood of returning ratio for disclosure strategy II (D2) (i.e. when subjects receive disclosure that their returns are outsourced to an overseas location) was 40.875 whereas the mean likelihood of returning ratio for disclosure strategy 1, D1 (i.e. when subjects receive disclosure of outsourcing of their returns' in the AICPA recommended format) was 55.362. This result is consistent with H1 and therefore hypothesis 1 is supported. Post hoc comparisons for the disclosure strategy variable are presented in Table 4. These tests reveal that a significant difference ($p < 0.013$) exists between D1 and D2 suggesting that there is a significant difference in the client's reaction to information disclosed in the AICPA recommended format versus disclosure that clearly states that the returns are being outsourced overseas.

Table 3. Estimated Marginal Means for Disclosure Strategy Variable

Disclosure Strategy (IV)	Mean	Std. Error	95% Confidence Interval	
			Lower Bound	Upper Bound
1	55.362	3.399	48.662	62.062
2	40.875	3.330	34.310	47.440
3	53.613	3.392	46.927	60.298
4	75.186	3.363	68.556	81.816

Hypothesis 1a (H1a) predicts the clients will prefer to have their returns prepared in-house than by a TPSP that is located overseas. Table 3 indicates that the mean likelihood of returning ratio for disclosure strategy IV (D4) (i.e. when subjects receive disclosure that their returns are prepared in-house by employees of the firm) was 75.186 whereas the mean likelihood of returning ratio for D2 was 55.362. Table 4 reveals that an examination of the Student Newman-Keuls post hoc tests indicates that a statistically significant difference ($p < 0.000$) exists between D4 and D2. This result is consistent with H1a and therefore hypothesis H1a is supported. Hypothesis 1b (H1b) predicts the clients will prefer to have their returns prepared in-house rather than being outsourced to a provider located within the US. Table 3 indicates that the mean likelihood of returning ratio for D4 which was 75.286 is significantly different from the mean likelihood of returning ratio for disclosure strategy III (D3) (i.e. when subjects receive disclosure that their returns are outsourced domestically) which was 53.613. This result is supported in Table 4 which reveals that a statistically significant difference ($p < 0.000$) exists between D4 and D3. This result is consistent with H1b and therefore hypothesis H1b is supported.

Table 4. Multiple Comparisons (Post Hoc)

	(I) Disclosure Strategy (IV)	(J) Disclosure Strategy (IV)	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
						Upper Bound	Lower Bound
Tukey HSD	1	2	14.57(*)	4.750	.013	2.27	26.87
		3	2.04	4.793	.974	-10.38	14.45
		4	-19.63(*)	4.771	.000	-31.98	-7.27
	2	1	-14.57(*)	4.750	.013	-26.87	-2.27
		3	-12.53(*)	4.750	.044	-24.83	-.23
		4	-34.20(*)	4.728	.000	-46.44	-21.95
	3	1	-2.04	4.793	.974	-14.45	10.38
		2	12.53(*)	4.750	.044	.23	24.83
		4	-21.66(*)	4.771	.000	-34.02	-9.31
	4	1	19.63(*)	4.771	.000	7.27	31.98
		2	34.20(*)	4.728	.000	21.95	46.44
		3	21.66(*)	4.771	.000	9.31	34.02

Hypothesis 2 (H2) predicted that likelihood of returning under decreased fees, pricing strategy I would be significantly higher across all the levels of disclosure strategy than likelihood of returning under no change in fees. However, Table 2 reveals that the pricing strategy variable does not have a significant main effect on client's likelihood of returning $F(1, 211) = .381, p = 0.538$. The mean likelihood of returning under pricing strategy I was 57.299 whereas the mean under pricing strategy II was 55.218. Thus, there was no statistically significant difference among the means of the two pricing strategy levels. These results are not consistent with H2. Therefore, H2 is not supported. An interaction was predicted between the disclosure strategy levels and pricing strategy levels is predicted by Hypothesis 3 (H3). However, as indicated in Table 2, this interaction was not statistically significant $F(3, 211) = .766, p = 0.514$. Therefore H3 is not supported.

Table 5. Demographic Data

Gender	Number of subjects	Highest Degree acquired	Number of subjects	Annual Income	Number of subjects
Males	119	High School	116	<15000	122
Females	100	Undergraduate	76	15000 – 49999	66
		Graduate	22	50000 – 74999	11
		Other	5	>75000	18

Table 5 reports demographic information about the respondents. Forty-five percent of the respondents were female. Fifty-three percent of the sample had at least a high school degree, thirty-five percent had a bachelor' degree and twelve percent had graduate and other degrees. Fifty-six percent of the sample reported income under \$15,000, thirty percent earned between \$15,000 and \$50,000, and the remaining fourteen percent reported income over \$50,000. Ninety percent of the sample had filed a tax return in 2005 and forty-two percent reported using a paid preparer for filing their tax return. The average age of the respondents was 25 and the average full time work experience was five years. The average number of years that the respondents had been filing tax returns was seven years.

Table 6. Direct Measures of Client's Attitude towards Outsourcing and Offshoring

Questions	Scale	D1P1	D2P1	D3P1	D4P1	D1P2	D2P2	D3P2	D4P2	Total
2.b. How important was the following factor in making your decision: Confidentiality of data	1-7	5.63	5.93	5.93	NA	5.00	4.38	5.08	NA	5.32
2. c. How important was the following factor in making your decision: Quality of tax returns prepared by TPSP	1-7	6.00	5.90	5.65	NA	5.84	6.32	6.04	NA	5.96
25. If a tax preparer uses the services of a TPSP located within the US, the quality of my tax returns will be lower, higher or same	1-3	2.16	2.07	2.00	2.00	2.04	1.81	1.85	2.11	2.00
26. If a tax preparer uses the services of a TPSP located overseas, the quality of my tax returns will be lower, higher or same	1-3	1.36	1.79	1.29	1.32	1.69	1.70	1.48	1.46	1.51
27. Confidentiality of my personal data will be safe if I use a TPSP who transfer my information, under his or her supervision, to a TPSP located in the US for completion of my tax return	1-7	3.80	4.31	4.18	3.92	3.89	4.00	4.19	4.21	4.06
28. Confidentiality of my personal data will be safe if I use a TPSP who transfer my information, under his or her supervision, to a TPSP located overseas for completion of my tax return	1-7	5.12	4.79	5.21	5.38	4.89	5.37	4.70	5.00	5.06
29. If I use a tax-preparer to prepare my tax return, that preparer should ask for my specific consent when using the services of a third party provider located in the U.S.	1-7	1.88	2.38	2.11	1.96	2.24	1.74	2.07	2.18	2.07
29. If I use a tax-preparer to prepare my tax return, that preparer should ask for my specific consent when using the services of a third party provider located overseas.	1-7	1.64	2.52	2.07	2.00	1.62	1.70	2.22	1.89	1.96
31. If I use a tax-preparer to prepare my tax return, that preparer is behaving unethically if the preparer sends my confidential information without my knowledge to a third party provider located within the U.S.	1-7	2.48	2.66	2.25	2.35	2.03	2.26	2.41	2.43	2.36
32. If I use a tax-preparer to prepare my tax return, that preparer is behaving unethically if the preparer sends my confidential information without my knowledge to a third party provider located overseas.	1-7	2.08	2.72	2.18	2.12	1.52	1.81	2.22	2.21	2.11
33. If my tax return is outsourced to a provider located within the US, the fees for my return should decrease.	1-7	2.72	3.86	3.29	3.31	3.21	3.04	3.23	3.46	3.26
34. If my tax return is outsourced to a provider located overseas, the fees for my return should decrease.	1-7	2.16	3.31	3.18	3.27	3.31	2.93	2.92	3.04	3.01

Table 6 reports the results of the questions used to directly measure the respondents' attitudes towards concerns related to the outsourcing and offshoring of their tax returns. On average, respondents considered confidentiality of their data (mean 5.32 on a 7 point scale, where 1 = not very important and 7 = very important) and quality of the tax returns prepared by the TPSP (mean 5.96 on a 7 point scale, where 1 = not very important and 7 = very important) as important factors in making their decision to return to the same firm. Respondents' believed that if their return was outsourced within the US to a TPSP, the quality would be lower (mean 1.51 where 1= lower quality, 2 = same quality and 3 = higher quality) whereas if it was outsourced overseas, quality would be even lower (mean 1.51). They displayed strong agreement with the statement that asked whether the respondent's specific consent should be secured before outsourcing their returns within US (mean 2.07 where 1 = strongly agree and 7 = strongly disagree) and whether the preparer is behaving unethically by not procuring the respondent's consent (mean 2.36).

Table 7. OLS Regression analysis for patriotism, risk aversion and political ideology

		Unstandardized Coefficients		Standardized Coefficients	t-statistic	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			B	Std. Error
	(Constant)	50.933	14.587		3.492	.001		
	Patriotism IV	-.924	.305	-.401	-3.033	.004	.926	1.080
	Risk aversion IV	.513	.721	.091	.712	.480	.996	1.004
	Political Ideology IV	3.513	2.644	.176	1.328	.190	.923	1.083

They displayed even stronger agreement with the statement that asked whether the respondent's specific consent should be secured before outsourcing their returns overseas (mean 1.96) and whether the preparer is behaving unethically by not procuring the

respondent's consent (mean 2.11). They disagreed with the statements that asserted that confidentiality of their data would be safe if their returns are outsourced within US (mean 4.06) and even more so, if the returns were outsourced overseas (mean 5.06). Lastly, when asked if fees should be decreased when returns were outsourced within US, they displayed moderate agreement (mean = 3.26) though they displayed stronger agreement for fee reduction when returns are outsourced overseas (3.01).

To further investigate, the reasons underlying the client's averseness to offshoring, three factors were considered. These factors were respondent's level of patriotism, respondent's attitude towards risk and respondent's political ideology. These factors may provide further insights on underlying factors that may explain the respondents' averseness to offshoring. I employed an OLS regression to test if there is a causal relationship between patriotism, risk aversion, political ideology and likelihood of returning (See Table 7). The coefficient for patriotism is negative and statistically significant. The coefficient value is -0.401 ($p = 0.004$) which suggests that there is a strong negative correlation suggesting the higher the level of patriotism, the lower will be the likelihood ratio and vice versa. The risk aversion variable ($p = .480$) and political ideology variable ($p = .190$) were not statistically significant suggesting that these factors did not impact the respondents' likelihood of returning.

Discussion and Conclusion

The findings and implications of this study have to be considered within the context of its strengths and limitations. Laboratory experiments have the potential for high internal validity due to the controlled environment within which the decision-making

behavior can be studied (Rutledge and Karim, 1999). Consequently, one must exercise caution in generalizing the results to other groups and situations. In experiments of this type, the case situations are simplified abstractions of real world situations (Rutledge and Karim, 1999). Therefore, although due care was taken to ensure that all necessary and relevant information was included, the cases remain abstractions.

The AICPA revised its ethics rulings in order to ensure that if the member intends to use the services of a TPSP, the client should be informed. The revised rulings do not differentiate between disclosures of outsourcing of tax returns within the US versus offshoring. This could be considered a significant area of concern because there are ethical and economic considerations involved in offshoring of returns that are distinctly different from outsourcing returns within the US. The economic issue is whether the client makes different decisions once they find out that their returns are being offshored. If clients decide not to return to the CPA firm the following year, it is evident that CPA firms would lose revenue. Therefore, the CPA firms have strong economic motivation to not disclose the location of the TPSP in order to retain their clientele. The ethical concern central to this issue is the CPAs 'professional responsibility to their client. The pursuance of economic gains over public interest may endanger the credibility of the firm and damage the reputation of the entire professional body. The findings of this study confirm that the taxpayers are not indifferent between outsourcing and offshoring of their returns, as suggested by the AICPA ethics rulings, and would prefer disclosure in clear simple terms, unlike the disclosure format recommended by the AICPA.

. This study uses a laboratory experiment to consider this conflict by examining the effect of various disclosure strategies and pricing strategies on the client's likelihood of

returning to the same CPA firm the following year for tax return preparation. Three research hypotheses were developed and tested in a laboratory experiment. Four levels of disclosure strategies were manipulated to test for a main effect on client's likelihood of returning. Based on the first and second hypotheses, main effects for the disclosure strategy variable and pricing strategy variable were expected. Further, in conjunction with the third hypothesis, an interaction was predicted between disclosure strategy levels and pricing strategy levels. A statistically significant main effect was found for the disclosure strategy variable on the client's likelihood of returning. This result provides support for H1, H1a, and H1b suggesting that clients are sensitive to the kind of information that is provided to them and change their decisions based on the information provided.

The average likelihood of the client returning to the firm was significantly lower when there was disclosure that returns are being offshored (40.875) than when there is disclosure in the AICPA format which conceals the location of the TPSP (55.362). This result confirms the prediction made in this study that the AICPA disclosure is not adequate, is misleading and attempts to conceal valuable information. The AICPA members want to maximize the taxpayer's likelihood of returning to the same firm the following year for tax return preparation because losing repeat customers will hurt their socio-economic interests. Thus, the AICPA member will react favorably to a disclosure strategy that maximizes the likelihood of returning and will be averse to any disclosures that lower the likelihood of returning. Moreover, the client's likelihood of returning under the AICPA disclosure format (55.362) is similar to the client's likelihood of returning under disclosure that returns were outsourced within US (53.613). This result suggests

that clients are interpreting the AICPA disclosure as their returns are being outsourced within US and not overseas. This would be a logical assumption since the AICPA disclosure does not reveal the location of the TPSP in any clear terms. H1a and H1b clearly bring forth the client's preference to have their return prepared in-house by employees of the CPA firm than have it outsourced to a TPSP within US or overseas.

Pricing strategy did not a significant effect main effect on likelihood of returning. H2 predicted that decrease in fee will be viewed favorably by taxpayers and will increase the likelihood of returning to the same firm for tax return preparation the following year in all the three cases, outsourcing within the US, offshoring, and returns are prepared in-house, as opposed to no change in fees. However, H2 was not supported. H3 predicted an interaction effect between disclosure strategy levels and pricing strategy levels. The most important implication from this study is that the level of disclosure can influence clients' decisions. However, the AICPA have failed to recognize the need for adequate disclosure and insist that the ethics rulings in their revised format address the needs of the public. The results of this study suggest that the AICPA recommended disclosure format is incomplete and need to be revised to include information about the location of the TPSP and maybe, even, include a requirement to procure the client's specific consent before outsourcing their returns. Findings from such research could produce considerable benefits to the business community. The study brings forth important public policy implications for protection of consumers who constitute the most vulnerable targets with regard to the detrimental effects of offshoring. The findings of this study may lead regulators to review the adequacy of the disclosure rules and may induce the recommendation of changes.

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CHAPTER THREE: STUDY TWO: THE COMMERCIALIZATION PROJECT: THE AICPA RHETORIC SURROUNDING THE TAX RETURN PREPARATION OUTSOURCING DISCLOSURE RULES.

Introduction

I understand that outsourcing of work has been going on for a long time, however, I do believe that this information should be made available to the client and his/her consent obtained prior to using a third party, especially if the third party is located in a foreign country. If this information is not disclosed to the client, I believe this issue is a time bomb waiting to go off. It is only a matter of time before clients discover that outsourcing to foreign countries is being widely utilized, which will add another scar to the public image of CPAs (AICPA, Appendix D, 2004b)

Recent scandals such as Enron, Worldcom and the demise of Arthur Andersen have intensified debates about the commercialization of accounting. Such debates emphasize the importance of further examining the practices of accountants and auditors, and not relying on the discursive claims of professional associations and leaders of the industry that they are indeed professional (Simmons and Neu, 1997). When the accounting practitioners talk about being enterprising and modern, it would be useful to examine whether claims to professional values might be a strategy to be commercial (Cooper and Robson, 2006). Appeals to such forms of social and cultural capital can be an effective strategy for professionals in developing their business and being profitable (Cooper et al., 1996). It will be beneficial to conduct studies that show that commercialization is not necessarily an antithesis to professionalization but examine the work practices and client relations of professional organizations, particularly how claims to be commercial and professional are selectively used in such organizations (Alvesson and Karreman, 2004).

This paper aims its focus on the activities of one such professional organization, the American Institute of Certified Public Accountants (AICPA). In the last few decades,

professional accountants have been successful at expanding their jurisdiction to several other domains, such as those of management advisory services and state auditing (Power, 1997, Sikka and Wilmott 1997). However, accountants in North America recently experienced significant difficulties with several jurisdictional claims sponsored by their accounting institutes, such as the Webtrust e-commerce seal of assurance (Gendron and Barrett, 2004) and the AICPA global credential project (Shafer and Gendron, 2005) and the Vision Project (Fogarty et al., 2006). The Vision document was prepared for a profession that envisaged free floating expertise. By contrast, the profession now faces unprecedented constraints in the United States and a series of regulatory reviews elsewhere, as governments and regulators in many countries seek to proactively take up the lessons of the Enron imbroglio (Fogarty et al., 2006).

The public accounting profession in the US suffered a major setback since Enron, Worldcom and other accounting scandals resulted in the passage of the Sarbanes- Oxley Act of 2002, the most wide-ranging federal statutory intervention in US capital markets and the accountancy profession since the 1930s. The new Public Company Accounting Oversight Board forbids financial information system design and implementation, record keeping, internal auditing, management and HR functions, investment banking, legal and expert services unrelated to auditing and can forbid any other line of business by rule, making the entire scope of services a regulated phenomenon (Sarbanes-Oxley Act of 2002, Section 201). Having fought off regulation in vain, AICPA President and CEO Barry Melancon now acknowledges that the accounting profession faces a great crisis and it is essential to restore the profession's most priceless asset—their reputation and their credibility and ability to self-regulate (Melancon, 2002).

However, the AICPA is once again in the midst of a controversial issue which is overseas outsourcing of tax return preparation, also known as offshoring, and whether, the fact that tax return preparation services are being offshored, should be disclosed to the client (AICPA, 2004a, IRS, 2006). Recently, members of the U.S. Congress, the media, and state and federal regulators have held open discussions about the responsibilities of businesses to disclose to their customers and clients when they outsource services or production to other countries (AICPA, 2004b). Risks to privacy and the inability of the individuals and the government to seek redress for privacy violations and data security breaches have been addressed by organizations such as the Privacy Rights Clearinghouse and the Federal Deposit Insurance Corporation as well as in extensive press coverage (PRC, 2006).

Consequently, the AICPA Professional Ethics Executive committee (hereafter PEEC) began a project to assess whether or not the AICPA Code of Professional Conduct (the “Code”) sufficiently addresses the members’ obligations when outsourcing services to third party service providers (hereafter TPSP) (AICPA, 2004b). The PEEC examined the effect that outsourcing of accounting and tax services has on integrity, objectivity, compliance with standards and confidential client information and issued an Exposure Draft in early 2004. It received 49 comment letters to that Exposure Draft. Some minor modifications were made to the Exposure Draft based on the feedback received and the final ethics rulings were issued on October 28, 2004. The new pronouncements took effect for all professional services performed on or after July 1, 2005⁴. The new requirements (Refer Table 1) state that if the member intends to use the services of a

⁴ They do not apply to professional services that are performed pursuant to agreements that are in existence on June 30, 2005 that are completed by December 31, 2005.

TPSP, the client should be informed and be given the opportunity to ask questions concerning the use of the service provider. Additionally, members must enter into contractual agreements with any TPSP to maintain confidentiality of the clients' information.

A glaring feature of the AICPA's revised ethics rulings is that no distinction has been drawn between a domestic TPSP and a TPSP that is located overseas. The AICPA's blanket disclosure format seems to suggest that there are no significant differences between outsourcing domestically and offshoring and that detailed disclosure of offshoring is unnecessary and not a cause for concern. The AICPA's arguments seem to serve as a defense by an association that has indeed proactively revised the ethics rulings while struggling to regain the ability and the credibility to self regulate. However, the revision could be serving more as an attempt at gaining legitimacy for the propriety of the new activity and less as an honest attempt at being candid about the nature of the activity. The public interest orientation of professions dictates that the clients have a right to know if their confidential information is being sent overseas outside the US jurisdiction where privacy and security law do not apply. The revision may reflect the accounting profession's continuing deep-rooted concern to further its own economic and social self-interests over the public interest.

The purpose of this analysis is to study the commercialization of the accounting profession using Giddens (1990) theory of trust and expert systems and the private interest model (Parker, 1994) of accounting profession's ethical claims in the context of the AICPA's revised ethics rulings regarding the disclosure of outsourcing of tax return preparation. Specifically, I intend to explore the mechanics and the rhetoric employed by

the AICPA to revise the ethics rulings (No.112, No.12, and No.1) relating to disclosures made to clients by tax firms regarding outsourcing of tax returns to TPSPs. The issues that are central to this study are the members' motivation to avoid full disclosure in order to further their private interests to preserve their socio-economic status with the use of the code of ethics as an instrument that aids promotion of members' private interests; public confidence in the accounting profession and possible impairment of trust; and the commercialistic outlook of the profession and the heightened concern with being more profitable. The paper attempts to enforce the view that professional change is not necessary, evolutionary, or motiveless but instead is a diffuse political process addressing multiple potential constituencies (Radcliffe et al. 1994).

Giddens' theory of trust and expert systems is used in this study to examine trust issues between the lay person, i.e. the client, and experts systems, i.e. accounting systems and also trust issues within the members of expert systems. This study also uses the private interest model (Parker, 1994) of accounting profession's ethical claims to understand how the latent private interest role of the ethical codes may supersede the manifest public interest role. Evidence was gathered through a latent content analysis of archival material supplemented with interviews with overseas TPSPs. Finally, I examined archival material until a point of evidential saturation was attained (Lincoln and Guba, 1985 and Van, 1988). Archival material took the form of public records (Denzin, 1978) as well as business press coverage of the events examined (Freidson, 1984). Public material included: Exposure draft of omnibus proposal of professional ethics division interpretations and rulings, Comment letters received in response to the exposure draft, Ethics rulings under the AICPA code of conduct and IRS Revenue rulings, AICPA

comments in response to the IRS proposed regulations, FDIC report, GAO report, speeches by AICPA members, and hearing archives of the subcommittee on oversight of the House Committee on Ways and Means. Press coverage involved articles, editorials, and advertisements in various journals.

The paper is organized as follows. In Section 2, I provide a background of offshoring and the issues and events surrounding the revision of the AICPA ethics rulings regarding disclosure of outsourcing tax returns. Section 3 discusses the theory employed and methods, which consist of latent content analysis of archival material supplemented by interview data. In section 4, I present the analysis of the three major issues underlying the AICPA's revised ethics rulings. The final section discusses the paper's main findings and implications of my research.

Background: Offshoring and the events leading to the AICPA rulings

The succeeding discussion provides a background of the practice of offshoring and brings forth the distinction between outsourcing domestically versus offshoring followed by an examination of the discourses surrounding the revision of the AICPA ethics rulings. The aim of this examination is to understand the issues and events surrounding the revision of the rulings.

Offshoring of tax returns: background

The trend of outsourcing preparation of income tax returns overseas, particularly to India, began about five years ago and shows no signs of abating (Soled, 2005). There are a number of reasons for the growing popularity of this practice. The primary reason is cost arbitrage. Offshored tax returns can be prepared in a cost-efficient manner by a highly skilled workforce (Soled, 2005). The second reason is the practical efficiency

afforded by an overseas workforce coupled with the advent of technology that enables speedy data transfer. The time-zone differences create virtual twenty four hour operations since the daily close of operation in the U.S. accounting firms is marked by the start of the work day for overseas accountants. Thus, offshoring can improve client service by speeding the delivery of completed returns (Robertson et al. 2004). Thirdly, offshoring is designed to reduce the tax season pressures that have long plagued public accounting. Finally, the accounting firms want to maintain their competitive edge (Soled, 2005). The large accounting firms fear that if competitors offshore and they do not, they may ultimately price themselves out of the marketplace. (Soled, 2005).

One of the greatest concerns about offshoring is the privacy and security risk of posting confidential client information such as social security numbers to a facilitator's website. Clients may not be in favor of their information being sent to a third party who is not directly supervised by their CPA. A second concern about offshoring is that it limits the tax preparation experience of entry-level accountants (Robertson et al. 2004). Decreased staff morale and staff concerns about layoffs are also important challenges to a firm considering offshoring tax services. Firms may also be concerned that political instability in the country of the service providing company may interrupt processing operations. Another barrier to effective offshoring is technology capability. Firms must have the technology capabilities, including hardware, data storage, software, and knowledgeable people, to move manual processing to a web-based processing system. Finally, clients and CPAs may have service quality or patriotic concerns about the offshoring of tax preparation work (Robertson et al., 2004). The wrenching events of recent years have intensified patriotism throughout the United States since many U.S.

workers have lost jobs to cheaper third-world labor. There are AICPA members who are of the opinion that clients may view offshoring as yet another myopic approach that needlessly diminishes the U.S. job market (Shamis et al., 2005).

The offshoring of tax preparation services raises several legal and ethical concerns. Legally, a key question relates to the potential liability the U.S. tax preparer incurs when hiring foreign subcontractors to process tax returns for U.S. taxpayers. Ethically, a primary question concerns whether the tax preparer has a duty to disclose to clients the use of offshore tax preparers (Bierce, 2004a). The offshoring of tax returns has invoked mixed reactions. Federal agencies, regulators, academics and the media have attempted to address the looming threats of this fast-growing practice that accompany the unconcealed gains (GAO, 2005; IRS, 2005; PRC, 2006; AICPA, 2004b; Robertson et al., 2004; Soled, 2005, and Reeves 2004). The AICPA standpoint on the practice of offshoring is that it is an economic activity that is imperative for economic development. The AICPA describes offshoring of tax returns as an improvement of work processes and a step towards the adoption of modern business practices in today's global marketplace (AICPA, 2006). There are a number of regional and local accounting firms located in border states that have significant cross-border working arrangements with professionals located in Canada, Mexico and Latin American countries. The AICPA claims that from their perspective, the AICPA ethical rules will safeguard confidential taxpayer information and at the same time, be flexible enough to promote productive economic relationships between countries (AICPA, 2006).

The AICPA asserts that offshoring is a part of the process of changing market conditions. In an AICPA leadership speech Robert Bunting, Chair of the AICPA at a

SEC-PCAOB Conference, campaigned change as inevitable and desirable and urged the AICPA in the spirit of a great profession to embrace the change rather than shy away from it:

Perhaps more than anything else, we must always keep in mind another need: The need to be able to change. Great professions don't just accept change. They don't just embrace it. Great professions initiate change – for their own good, for the public good, and for the good of the future. Change can be a tough road to travel. But it is also a necessary road to travel. It takes us where we want to go. One of my priorities is to ensure that the AICPA takes that road. My goal is to ensure that the AICPA is an organization that continues to promote change, rather than recoils from it – because that is what great professions do” (AICPA, 2004d).

The issues surrounding the revision of the AICPA Ethics Rulings

The process of preparing income tax returns has gone through dramatic changes. In the mid-1970s, outsourcing of electronically filed returns and other tasks involved in preparation of tax returns would be considered a newfangled practice (Coustan, 2006). Presently, tax return preparation is being recognized as, perhaps, the predominant product of outsourcing to date (Cook et al. 2005). Though, offshoring opens up avenues for increased revenues and speedy delivery of returns, there may be unintended consequences to modifying business processes which expose firms' offshoring tax returns to additional business risks. The AICPA is faced with a business opportunity while concurrently managing its currently precarious position on an ongoing basis. Past scandals and loss of reputation dictate the importance of maintaining credibility to be able to self-regulate (Melancon, 2002).

Therefore, unlike in the past, the AICPA decided to take action proactively and review the code of conduct regarding disclosure of outsourcing of tax returns to determine whether the code was sufficient or needed to be amended. The AICPA spearheaded the effort as evidenced in their introduction to the exposure draft that stated:

As a result of recent discussion and debate by members of Congress, the media, and state and federal regulators about the responsibilities of businesses to disclose to their customers and clients when they outsource services or production to other countries, the PEEC began a project to assess whether or not the AICPA Code of Professional Conduct (the “Code”) sufficiently addresses our members’ obligations when outsourcing services to third-party service providers (AICPA, 2004b).

The PEEC appointed a task force in January 2004 to consider what changes, if any, should be made to their Code of Professional Conduct in connection with the use of third party providers. Concurrently, other government agencies were conducting studies to address concerns regarding the impact offshoring may have on privacy of data (FDIC, 2004). The Federal Deposit Insurance Corporation (FDIC) conducted a study with regard to the associated risks of offshoring by financial institutions from a safety and soundness perspective and with particular emphasis on the threats posed to customer privacy in June 2004. Their findings recommended disclosure of undisclosed third-party contracting arrangements since they may increase risk in outsourcing relationships. This potential increase in risk occurs regardless of whether the undisclosed third party resides domestically or offshore; however, inherent outsourcing risks may be amplified due to unique country risk when the third party is an offshore vendor. Their recommendation is that financial institutions that outsource data to domestic vendors should be aware when domestic vendors have in turn subcontracted out that same work to overseas or domestic third parties (FDIC, 2004).

The Committee on Ways and Means and its Subcommittees under the House of Representatives conducted oversight hearings during the 108th Congress invited comments from committee members regarding tax practitioners and their professional

responsibility regarding outsourcing and offshoring of tax returns (Committee on Ways and Means, 2004).

On August 9, 2004, an exposure draft was issued by the PEEC. The draft contained a number of important proposals for review and comment by the AICPA's membership and other interested parties regarding pronouncements for possible adoption by the PEEC. Despite the widespread agreement among various federal agencies (PRC, 2004; FDIC 2004) as suggested in the foregoing discussion over the increased risks that are associated with offshoring, the PEEC maintained the position that outsourcing domestically and offshoring have been, and should be given, equal weight (AICPA, 2004b). The language they used suggests that the PEEC would use the same standards for outsourcing as they would for offshoring. This logic is evident in the following statement of the exposure draft:

Although the media and representatives of our federal and state governments have focused on the issue of "offshoring," the committee believes that guidance concerning the use of third-party service providers should apply equally to service providers located domestically and abroad (AICPA, 2004b).

The following comment by Ochenschlager, vice president of taxation at the AICPA, resonates with similar intent that the disclosure will disclose offshoring of tax returns but will not be restricted to that. It will go a step further and include disclosure of outsourcing to domestic service providers as well:

But under the AICPA rule, the outsourcing doesn't necessarily have to be overseas. If it's outsourced anywhere, overseas or domestically, it has to be disclosed (Coombes, 2006).

The PEEC invited the AICPA members to submit their comments to the draft and all comments received were considered by the committee at an open meeting scheduled on October 28, 2004. A number of the members of the AICPA were not in agreement with

the revisions suggested in the exposure draft and stated their reservations in the form of comment letters (AICPA, 2004c). However, the majority seemed to support the ruling since the AICPA has approximately 350,000 members but only forty nine comment letters were received. Out of the forty nine letters, only twenty four supported disclosure of offshoring and felt that there was too much latitude regarding the nature, content, and form of the disclosure. Some minor modifications were made to the Exposure Draft based on the feedback received and the final ethics rulings were issued on October 28, 2004. The new pronouncements took effect for all professional services performed on or after July 1, 2005⁵. The revised rulings (Refer Table 1) state that if the member intends to use the services of a TPSP, the client should be informed and be given the opportunity to ask questions concerning the use of the service provider. Additionally, members must enter into contractual agreements with any TPSP to maintain confidentiality of the clients' information.

Pursuant to the revision of the AICPA rulings, the IRS, in December 2005, issued a press release entitled "IRS Issues Proposed Regulations to Safeguard Taxpayer Information". The stated purpose of the IRS regulations (Refer Appendix A) is to prevent offshore outsourcing of tax return preparation without the taxpayer's knowledge, as well as to "update" regulations that had not been revisited since the 1970s (Nolte, 2006). The proposed rules have a separate customer consent provision that applies to return preparers who outsource their work overseas. The efforts of the AICPA to storm ahead with the offshoring of returns will be decidedly stalled by the proposed IRS regulations that are awaiting approval. Tax laws are a powerful tool for public policy and can promote or

⁵ They do not apply to professional services that are performed pursuant to agreements that are in existence on June 30, 2005 that are completed by December 31, 2005.

impede virtually any type of investment or commercial opportunity (Bierce, 2004b). The IRS ruling is in direct conflict with the AICPA's interests and the AICPA in their comments to the IRS adopts a stance which is completely opposed to the stance of full disclosure that the IRS is advocating (the kind one would have expected the AICPA to have suggested). A detailed analysis of the opposing viewpoints is presented in section 4.

The importance of distinguishing between outsourcing and offshoring risks was also brought forth in a report to Congressional Committees called "Offshoring of services: an overview of the issues" presented by the United States Government Accountability Office (GAO, 2005). The report outlined the potential impact of offshoring on the average U.S. standard of living, distribution of income, and security. The report stated that experts express varying degrees of concern about the impact offshoring may have on personal privacy when medical and financial records become accessible in overseas locations. Privacy advocates, academics, and offshoring researchers have noted concerns with the possibility that personal information sent to foreign locations could be improperly released, leading to identity theft, diversion of funds, and breaches of confidentiality (GAO, 2005).

The IRS regulation is being opposed by consumer groups, the media, and the AICPA but for different reasons. Numerous comments have been received on the proposed rules and a public hearing on them was scheduled for April 4, 2006. After the hearing, the Treasury Department and IRS consider all comments and finalize a rule that takes them into account. On April 6, 2006, Thomas J. Purcell, (Chair, Executive Tax Committee, AICPA) in his testimony to the committee on Ways and Means during the 109th congress, commented on the IRS proposed changes to section 7216 regulations asserting that the

proposed regulations are drafted in a manner that adds unnecessary and extremely burdensome steps to the current tax return processes used by many professional service providers. The proposed IRS regulation has not yet been implemented and it is expected that the national debate between the AICPA and the IRS will be on-going. The political and social environment described in this section provides the backdrop against which the AICPA revised the ethics rulings regarding disclosure of outsourcing to TPSPs.

Research issues and methods

Research Issues

Based upon an analysis of three major issues implicit in the revised ethics rulings, it is possible to explain the AICPA members' stance regarding disclosure of offshoring of tax returns. These issues are: furthering members' private interests to preserve their socio-economic status with the use of the code of ethics as an instrument that aids promotion of those private interests; public confidence in the accounting profession and possible impairment of trust; and the commercialistic outlook of the profession and the heightened concern with being more profitable. Two theoretical tools are useful in understanding the revised ethics rulings: Parker's (1994) private interest model of ethics and Giddens' discussion of expert systems. This study employs the private interest model (Parker, 1994) of accounting profession's ethical claims to understand the manifestation of the private interest role that is fulfilled by ethical codes. The private interest can be defined as the latent motivation of ethical codes to protect the interests of the professional accounting body corporate and its individual members (Parker, 1994).

The public interest may be defined as both a manifest and latent motivation of ethical codes to protect the economic interests of professional members' clients and of third

parties who place reliance on the pronouncements and advice delivered by both the professional body and its members. Third parties may include corporate shareholders, borrowers, lenders, regulators, government, social interest groups, or any other member of the public (Parker, 1994). The pursuance of private interest over public kindles issues of trust between the client and the CPA firm. These issues of trust are examined with the help of Giddens' explanations of how lay people come to accept accountancy's expertise as applying to a broader range of activities and problems. For Giddens, the transference of expertise from one area to another indicates that lay acceptance can act at a very general level, without clear knowledge of what it is a profession or expert system knows or does, and with a general faith in expert systems overall. A detailed analysis of the issues described above with the help of the two theoretical tools follows in section 4.

Content analysis

Evidence was gathered through a latent content analysis of archival material supplemented with interviews. According to Berg (1989, p. 107), latent content analysis represents an "interpretive reading of the symbolism underlying the physically presented data" and thus focuses on "the deep structural meaning conveyed by the message".

Although there are dangers inherent in the drawing of inferences from such symbolism, it is nevertheless a very useful approach in examining archival material complicit in the exercise of power and exertion of influence (Merton, 1968, pp. 366–370). These dangers may, however, be mitigated by incorporating independent, corroborative techniques to methodologically triangulate on the phenomena of interest, as well as including detailed excerpts from material examined to substantiate interpretations (Berg, 1989, p. 107).

Within my work, I attempted to ensure the trustworthiness of findings in several ways.

Multiple sources of archival material were examined whenever possible. Therefore, not only were AICPA releases and rulings examined, but also press coverage of these rulings. I also believed that it was important to include within this paper exact, relatively lengthy, quotes from archives in order to avoid the potential flaw of quoting out of context and to substantiate interpretations. Finally, I examined archival material until a point of evidential saturation was attained (Lincoln and Gupa, 1985 and Van, 1988).

Archival material took the form of public records (Denzin, 1978) as well as business press coverage of the events examined (Freidson, 1984). Public material included: Exposure draft of omnibus proposal of professional ethics division interpretations and rulings, Comment letters received in response to the exposure draft, Ethics rulings under the AICPA code of conduct and IRS Revenue rulings, AICPA comments in response to the IRS proposed regulations, FDIC report, GAO report, speeches by AICPA members, and hearing archives of the subcommittee on oversight of the House Committee on Ways and Means. Press coverage involved articles, editorials, and advertisements appearing in the *CPA Journal*, *Accounting Technology*, *Insight*, *Newsreleasewire*, *Outsourcing Law*, *Journal of Accountancy*, *Market watch*, *Accounting Today*, and *Journal of Accountancy*.

Articles were identified using on-line search engines on newspaper, trade journals, professional publications, academic journal websites, social sciences research network, and general searches on library websites. I also collected and examined information on the AICPA website for press releases and pronouncements in relation to the revised ethics ruling. The articles were organized according to the issue they related to and were examined in detail to obtain some understanding of the core issues underlying the revision of the ethics rulings. The AICPA ethics rulings, press releases, comments made

to other agencies and discourses surrounding these events were carefully analyzed to unveil the hidden meaning, if any, embedded in the AICPA's actions.

Interview evidence

Interviews were conducted with three leading TPSPs to obtain first-hand data regarding the security procedures in place. Since security of confidential client information is one of the greatest concerns that the client has when data is offshored, discussions with the providers will provide valuable insights as to the validity of these concerns. The providers are located in India and since majority of the returns are offshored to India (Soled, 2005), this site was most relevant to the study. The three cases were selected from a list of fourteen leading suppliers that provide finance and accounting outsourcing services, compiled by the FAO Research Inc.

The interviews were semi-structured and the results of the interviews were used to corroborate the conclusions reached by conducting content analysis. The questionnaire consisted of a small number of open-ended questions. The interviews were tape recorded and transcribed. The typical interview was sixty minutes; the length varied from thirty minutes to ninety minutes. Members of the top management team as well as managers at operational levels were interviewed. Questions were directed at determining the specific risk reduction strategies that were adopted by the service provider to mitigate client's risks associated with confidentiality of their data. The service providers were asked how specific risks are identified and whether controls established are maintained to the level specified by the client. Questions were asked to gain an understanding of how the TPSP specifically deals with issues such as risk mitigation, business continuity, privacy, and information security.

The reading of the transcripts focused on identifying the measures adopted by the TPSPs to ensure that the information transmitted to them remains secure. The purpose of the interview evidence was to provide objective evidence so that the reader may form their own opinion about the procedures in place for the safe custody of data. The evidence however is anecdotal and does not represent all the service providers that may be used by the AICPA members. The interview data represents procedures that are being followed at leading TPSPs and it is not necessary that all overseas TPSPs adopt similar measures. However, it helps to provide insights about the best possible safety measures that can be adopted when returns are outsourced. One of the primary concerns underlying the issue of disclosing the outsourcing of tax returns is the transmitting of confidential client information to an overseas location. If there is no significant threat to confidentiality of information, then the AICPA may be justified in assuming that there is no additional threat posed to clients and specific client consent is not necessary. Thus, the interview will help to substantiate the validity of the claims made by the AICPA regarding the security and confidentiality of client's data.

The Study: Analysis of the Issues

In the following section, the three issues that are identified as problematic in the revised ethics rulings are analyzed. The first issue which is the AICPA members' furthering their private interest over the public interest is interrelated to the second issue which is the resulting loss of trust in the accounting profession. The AICPA members can advance their private self-interest over public interest only to the detriment of the trust that is vested in the profession (Brien, 1998). One may argue that the AICPA's decision

to offshore returns without client consent is only an attempt to use their expertise to make decisions in lieu of their clients who do not possess the knowledge, expertise or requisite information to make their own decisions. By doing so, the AICPA members are engaging in professional paternalism. Paternalistic behavior toward an individual is philosophically undesirable because it restricts the individual's autonomy and the individual's ability to make informed decisions (Dwyer and Roberts, 1998). Paternalism is defined as "the interference with a person's liberty of action, justified by reasons referring exclusively to the welfare, good, happiness, needs, interests, or values of the person being coerced" (Dworkin, 1971, p.108).

Professional paternalism is criticized because it devalues client autonomy (Dwyer and Roberts, 1998). The AICPA's refusal to disclose information about the geographical location of the TPSP represents unjustified professional paternalism. Moreover, refusal to disclose this information can also be interpreted as mystification of these practices arising from a self-interested need to maintain secrecy. This paper provides an opportunity to study a profession as it seeks to push the boundaries of its domain even when that stretches the limits of public interest. The revision of the ethics rulings can be comprehended as another initiative in the long line of initiatives (Fogarty et al., 2006; Gendron and Barrett, 2004; Barrett and Gendron, 2005; and Shafer and Gendron, 2005) revealing the third issue analyzed in this study which is the accounting profession's preoccupation with being commercial and profitable.

Furtherance of Private interest versus Public interest

The first issue that is addressed in this study is the possibility that the AICPA members are furthering their private interest over the public interest. Parker's (1994)

private interest model provides a framework to help understand the motivations underlying the furtherance of the AICPA members' private interest. One of the frequently cited characteristics of a profession is the existence of professional codes, often in the form of codes of ethics. Ethical codes are promulgated with the manifest objective of facilitating professional self-control as well as expressing and strengthening the community orientation of profession members (Barber, 1965). The Ethical codes have been observed to fulfill a number of private interest roles. These appear to be interrelated and focused upon the maintenance of professional authority. An examination of the key roles of the ethics codes helps us to understand them as interrelated component concepts of a private interest model of the roles served by ethical codes (Parker, 1994).

Professional Insulation: The underlying intent of this role is to maintain the profession's internal control over its own members and its own overall agenda, to protect members from the vagaries of control attempted or exercised by external parties, and to enhance the accounting profession's perceived authority in the business and general community. Hence the role of professional insulation contributes directly to the role of interference minimization, self-control and professional authority.

Interference minimization: The underlying intent of this role is to facilitate the profession's own self-control (rather than being controlled by other parties such as government or its agencies) and avoid counter-threats to the accounting profession's professional authority, prestige and influence in the business and general community. Hence the role of interference' minimization contributes directly to the roles of self-control and professional authority.

Self-control: The underlying intent of this role is to minimize the State's potential or actual regulation of the accounting profession, maintain profession member solidarity and restrain any temptation for members to publicly criticize each other or their profession and retain the profession's own perception of its professional authority, via self-regulation. Hence the role of self-control contributes directly to the roles of interference minimization and professional authority.

Professional Authority: The underlying intent of this role is to legitimize the profession's claimed territory and right to practice, secure public trust and approbation for the accounting profession and control the type of work and resulting economic rewards available to the accounting profession. Hence the role of professional authority contributes directly to the role of socio-economic status preservation.

Socio-economic status preservation: The underlying intent of the role of socioeconomic status preservation is to secure social legitimation and prestige for the accounting profession, protect the economic interests of profession members, and maintain members' ability and rights to earn economic rewards while supporting the accounting profession's pursuit of public trust and respect. Hence the role of socio-economic status preservation contributes directly to the role of professional authority. From the foregoing discussion, a private interest model of professional ethics conceptualizes five interrelated roles that ethics fulfill in serving the private interest of the accounting profession:

The model is represented in Fig. 1.

..... Insert Fig. 1 here.....

The linkages between its components are derived from the manifest and latent intentions underpinning each role. Figure 1 depicts the five private interest roles served by accounting ethics codes and their hypothesized interrelationships.

The AICPA revised its new ethics rulings to serve its private interests roles which are ensuring professional insulation, facilitating interference minimization, exerting self-control, maintaining professional authority and preserving socio economic status. The AICPA's proactive attempt to revise the ethics rulings evidences the desire of the AICPA to invoke the professional insulation and self-control role of ethical codes. Ethical violations have often been evaluated and redressed within the profession, based on the argument that outside parties lack the requisite knowledge to make proper evaluations (Mckinlay, 1973). Professional insulation is a role served by ethical codes constructed partly with a view to insulating the AICPA from observation and evaluation by outside parties. The existence of such formal codes is intended to dissuade such parties from any desire or felt need to scrutinize closely the profession's activities. Self-control retains the AICPA's ability to exercise control over its own activities and members. The revision of the ethical codes provides a potential signal to external parties that the profession perceives itself to be effectively regulating its own activities and hence the inference that no further external regulation of the accounting profession is necessary.

Interference minimization is an ethical code role of avoiding or minimizing interference in what the accounting profession regards as its own domain including type and scope of work undertaken, style of organization adopted, position in the business community and regulation of its own members and activities. For example, the PEEC states in the exposure draft that the committee remains committed to the belief that

disclosing confidential client information to TPSPs used in providing a professional service to clients would not constitute a release of confidential client information, and thus does not require specific client consent. Thus, the AICPA has chosen to extend the scope of the contract entered into between the client and the member by including a third party without the consent of the client. Such an act provides professional insulation thus promoting interference minimization and self control. The IRS's proposed amendment to IRC 7216 will require the specific consent of the client and is in direct conflict with professional insulation and hence professional authority. The AICPA has been adamant in expressing its concerns regarding the IRS's new rules fearing that this potential erosion of professional insulation will diminish their professional authority. In a testimony before subcommittee on oversight of the House Committee on Ways and Means, the Executive Tax Committee Chair argued that the AICPA ethics rules are more in line with modern business practices than what is provided for under the IRS proposed regulations. The AICPA's opposition to the IRS amendment is evident in the following statement that appeared in an article titled "AICPA urges IRS to reconsider proposed disclosure"

(AICPA, 2006a):

We are particularly concerned about the extent to which the proposed regulations fashion an entirely new consent regime for any return preparation activities that involve parties located outside the borders of the United States. The proposed regulations are drafted in a manner that adds unnecessary and extremely burdensome steps to the current tax return processes utilized by many professional service providers. It appears that at the very time the IRS is eliminating barriers to the achievement of its goal for increasing electronic filings and payments, the agency is incongruously making it more complex for its partners -- the professional providers of tax assistance and return preparation -- to sustain their current professional business processes.

The AICPA strongly encourages the IRS to adopt the various approaches suggested by our comments, as attached. If that is not acceptable, we urge the IRS to engage the professional service provider industry in a substantive discussion

prior to issuing final regulations about how to best ensure the requisite security of tax information in the context of today's modern (global) business practices.

The tone of the revised rulings suggest that the AICPA members are aware of their professional responsibility to the client and remain responsible even when a TPSP is used, thereby reminding regulators, members and federal agencies of their position in the business community and their ability to self-regulate. Claims made by the AICPA about 'reasonable assurance' and 'due diligence' are reflective of the professional authority role of the ethics rulings that emphasizes the supposed unique technical knowledge base of the accounting profession along with its resulting authority to exclusivity and professional judgment in its claimed domain. Professional authority is also invoked by the AICPA by reminding regulatory agencies of the stature of the profession. Burns and Haga (1977) contend that the profession ultimately employs intimidation whenever its autonomy or authority is seriously threatened by outside parties. The following statement, made by Thomas J. Purcell, Chair, Executive Tax Committee of the AICPA in his testimony before the subcommittee on oversight of the house committee on ways and means is reflective of the AICPA's attempt to assert its authority as described in Parker's model (Committee on Ways and Means, 2006):

The AICPA is the national, professional organization of certified public accountants comprised of approximately 330,000 members. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses. It is from this broad base of experience that we offer our comments today on the IRS budget and the 2006 tax filing season.

In the following statement, the AICPA continues to flaunt their professional authority vis-à-vis the authority of other regulatory agencies (Committee on Ways and Means, 2006):

The AICPA applauds Commissioner Everson's commitment to high standards for tax professionals and his efforts to upgrade the Office of Professional Responsibility. In this context, we have a longstanding track record of establishing high professional standards for our CPA members, including the AICPA Code of Professional Conduct and enforceable Statements on Standards for Tax Services.

Ethical codes may also play a role in safeguarding the socio-economic position of a profession's members. In preserving the socio-economic status of the accounting profession, ethical codes routinely include rules pertaining to member competition, service pricing policies, handing over clients between members, and tending practices. While professional insulation, self-control, professional authority, and interference minimization may be latent objectives underlying the AICPA's motivation to revise the rulings, the socio-economic status preservation role of the ethical codes may be the manifest objective of the revised rulings. Thus, the AICPA may be attempting to preserve members' socio-economic status with the use of the code of ethics as an instrument that aids promotion of members' private interests. The AICPA's preoccupation with preserving and sustaining their members' business practices in order to keep them competitive seems to override their obligation to reveal information to the taxpayer. The following statement brings forth the above argument (Committee on Ways and Means, 2006):

We recommend that, instead of the regime outlined in the proposed regulations, the IRS incorporate in the final regulations, the approach the AICPA has adopted for its members. Specifically, as described in our June 6, 2005 letter to IRS Commissioner Mark W. Everson, the AICPA has adopted two new and one revised ethics rulings, regarding a CPA's responsibilities when outsourcing services to third-party service providers whether domestic or offshore. These provisions, as described in more

detail below, provide a balanced approach for protecting taxpayer information while accommodating modern business practices. The proposed regulations prescribe dramatic differences in the forms of consent; i.e., based on whether the professional services are rendered from within the U.S and its territories or are provided (in whole or in part) from overseas; the regulations create rules that are significantly out of step with modern business practices.

The discussion above reminds us that the codes of ethics, in either a regulatory or self-regulatory regime are ineffective in promoting ethical behavior unless they are promoted, implemented and enforced. The code of ethics is a practical measure to promote trustworthiness of the members of the profession. In order to promote trust the profession must develop a culture of trust (Brien, 1998). A culture of trust has two elements. First, various beliefs, norms and values that focus on trust and exemplify it such as respect for individuals, sincerity, honesty, community service and a commitment to the profession's clients. Second, specific institutions that promote trust through their actions which includes codes of ethics, education programs, disciplinary bodies, adjudication and interpretation bodies, working in conjunction to articulate a professional ethic (Brien, 1998).

The trust that grounds any sort of cooperation is not unperceptive and is not invested unconditionally. The agent's activities continue but mechanisms exist to deal with untrustworthy behaviors such as education, opprobrium, criticism and exclusion which can be invoked in appropriate circumstances (Brien, 1998). Therefore, impairment of trust in the accounting profession and the resulting loss of public confidence draw our attention to the fact that the profession is not invulnerable to scrutiny or immune from accountability and stands to face consequences for pursuing unethical behavior.

Cultivating trust enables the profession to pursue the ideal of professionalism which can be pursued by an organization only if it is trusted since it assumes self-regulation, a

strong ethic and an altruistic orientation. Familiar features of professional life, such as autonomy and self-regulation are not simply the result of a specific bargain struck between the profession and society but are also a part of what it is to be a profession, and arise, in modern societies, as an act of trust on the part of society when the profession is constituted or from its ongoing maintenance (Brien, 1998). Thus, society must trust the profession in order for it to be in a position to move towards the professional ideal; and the profession must actively cultivate a culture of trust in order to attain the professional ideal.

Impairment of Trust and loss of public confidence

Trust issues between the lay person and expert systems

Giddens (1990, p.33) describes trust in modernity as related to absence in time and in space. There would be no need to trust anyone whose activities were continually visible and who's thought processes were transparent, or to trust any system whose workings were wholly known and understood. According to Giddens, it has been said that trust is "a device for coping with the freedom of others", but the prime condition of requirements of trust is not lack of power but lack of full information. Trust relations, therefore, are basic to the extended time-space distancing associated with modernity. The AICPA acknowledges that trust invested in the profession must be nurtured (AICPA, 2004d):

We must remember that of all of our assets, none is more precious than the position of trust we occupy in the marketplace. Regulators play a vital role for our profession. But the role of the regulator is to set the minimum requirements for protecting the public interest and disciplining those who fail to meet them. Our professional goal must go beyond that.

Giddens (1990, p.88) distinguishes between trust in systems versus trust in persons.

Giddens notes that trust in systems takes the form of faceless commitments, in which

faith is sustained in the workings of knowledge of which the lay person is largely ignorant while trust in persons involves facework commitments, in which indicators of integrity of others (within given arenas of action) are sought. The AICPA members enter into facework commitments with their clients when they agree to prepare the client's tax return. They are entrusted with the preparation of tax returns with a generalized sense of trust that confidentiality of client information will be maintained and all professional services will be performed with professional competence and due professional care. Clients might not have an expectation that a member would use a TPSP to assist the member in providing the professional services (AICPA, 2004). The AICPA seeks to remedy any loss of trust due to the expansion of the range of activities agreed upon by requiring the members to adequately plan and supervise the services provided by the third party provider and obtain sufficient relevant data to support the work product. However, the client may consider the act of offshoring of returns as a breach of trust vested in the member.

Giddens highlights the role of risk in potentially upsetting the acceptance of expert systems. He uses Luhman, (1988) and Luhman, (1979) observations to argue that trust is different than confidence in that trust implies an awareness of the risk that trust might be misplaced. This suggests that people consciously consider alternatives in deciding to take certain actions. Consequently, impairment of public confidence in the accounting profession can have dire consequences with the client opting out of the relationship due to loss of trust. The revised rulings can be understood as seeking to redirect expert systems across distanced time-space, so lay people come to accept accountancy's expertise as applying to a broader range of activities such as offshoring of tax returns.

For Giddens the transference of expertise from one area to another indicates that lay acceptance can act at a very general level, without clear knowledge of what it is a profession or expert system actually knows or does, and with a general faith in expert systems overall. Expert systems have no distinct knowledge base which can be reliably invoked for future services since the scope and nature of these services cannot be fully known in advance.

Just as Giddens envisages reliance on expert systems as a leap of faith (Giddens, 1990), so the revised rulings explicitly calls for a leap of faith from taxpayers in accepting the offshoring of their returns without their specific consent. The AICPA's reassurance that the TPSP will adhere to the standards set for the AICPA is arguable. This sentiment was echoed by Kathryn Means, CPA, Chair, FICPA Accounting Principles and Auditing Standards Committee in a comment letter to the exposure draft as:

The Committee agreed that the member should remain responsible but believed that it would be difficult for a member to be responsible for the "adequate oversight of all services performed by the third-party service provider and for ensuring that all professional services are performed with professional competence and due professional care". It appears that the AICPA is asking the third-party service provider to adhere to the standards that the member is bound by in regard to ethics.

Similarly, disturbances to this general faith are of acute importance because they threaten the generalized trust which might ordinarily flow to accountancy's claims to expertise. This trust does not require specific knowledge, but rather a general, pragmatic sense of functionality.

Giddens emphasizes that trust in abstract systems does not presuppose any encounters at all with the individuals or groups who are in some way responsible for them. But in the

large majority of instances such individuals or groups are involved as access points of the abstract system. Giddens (1990, p.86) also notes that, at access points, a clear distinction can be made between ‘frontstage’ and ‘backstage’ performances since control of the threshold between frontstage and backstage is part of the essence of professionalism. He argues that a clear distinction between the front and backstage reduces the impact of imperfect skills and human fallibility that might otherwise undermine the expert’s trustworthiness, something that those working at access points usually wish to minimize by concealing what occurs behind the scene and away from public view. Rhetorical ploys employed by the AICPA to enlist the support of its audiences for the revised rulings incorporates such key terms as: “responsible”, “honest and candid”, “due care”, “balanced approach”, “modern business practices”, “”, “productive economies”, “extremely burdensome”, “unnecessarily complicated”, “global marketplace” which help set up the frontstage for the offshoring practice. Robert bunting, Chair, AICPA reinforces the frontstage of the AICPA in his leadership speech with comments such as:

Objective advice, reliable financial information, efficiency, transparency and accountability are important to all institutions – and the mission of our members is to provide them.

As emphasized by Giddens (1990, p.88):

Access points are points of connection between lay individuals or collectives and representatives of abstract systems. They are places of vulnerability for abstract systems, but also junctions at which trust can be maintained or built up.

Thus, statements made by a AICPA member to argue that the reputable outsourcing providers apply security measures that far exceed the measures taken by many accounting firms in the U.S. are representative of the accounting profession at an access point

attempting to bring the skepticism of the lay person to rest as evidenced in the following statement:

The outsource providers operate their production facilities in a totally paperless environment. This strictly means that paper is absolutely not allowed in their production area. They do not allow pens, pencils, note pads or paper of any kind. Their staff members are not allowed to bring purses or brief cases into the production area. They have no removable media devices on their staff computers and no client data is ever stored on their hard drives. The preparation staff has no email capability, no instant messaging capabilities and very restricted access to the internet. In addition the staff is required to sign strict Non-Disclosure Agreements that prevent them from even discussing clients' data unless it is specifically related to work currently being preformed. Therefore, the security measures taken by leading outsourcing providers assure the highest level of security possible for the client's data. (Appendix MM, AICPA, 2004c).

The claims of rigorousness of the security structure of the TPSP enforce the front stage of the practice to help promote trustworthiness in the AICPA members' claims to expertise and reduce the impact of the possibility of human errors and imperfect skills. The position of the AICPA regarding client's confidential information seems to endorse the view that the TPSPs are competent and have procedures in place to maintain security that are heartwarmingly reliable. This sentiment was amplified by Ochsenschlager, vice president of taxation at the AICPA, who explained that, while he doesn't necessarily promote sending tax returns overseas, he did note that an AICPA member visited an Indian-based accounting-outsource firm and found that the company was abiding by stronger security measures than most U.S. accounting companies (Coombes, 2006). However, the truth in the assertions of the AICPA is debatable. As Giddens notes, experts can get things wrong, by misinterpreting or being ignorant of expertise they are presumed to possess (Giddens, 1990, p.86).

The above discussion about security and confidentiality of client information is supported by data from interviews conducted with three leading TPSPs regarding the

security and privacy measures that are in place in their organizations. The aim of the investigation was to obtain firsthand information about the systems installed and procedures followed by the TPSPs to ensure confidentiality and security of client information. Since the security of client information is at the heart of the offshoring controversy, in-depth interviews with service providers provided valuable insights which may not be revealed by a mere examination of archival documents. The providers were located in India and since majority of the returns are offshored to India, this site was considered as most relevant to the study. When asked how the providers specifically deal with issues such as risk mitigation, business continuity, privacy, and information security, Provider 1 explained there are many ways one can mitigate risk associated with information security and privacy of data. Starting with physical entry into the organization which is regulated at the reception desk, the kind of equipment that is allowed into the premises, such as a USB device or a camera phone, is also strictly monitored. Provider 1 stated that few companies implement the standards as strictly as they do though a lot of companies make tall claims about their security procedures:

Regarding Indian BPO providers, we are the number one company that implements security procedures. A lot of organizations say they do but they don't actually implement it. We actually implement it. For e.g. any e-mails coming into or going out of the organization, from an external email server, are tracked. Basically, the contents are tracked and if the content is extremely confidential, which is identified by the system itself, the mail is held in our server and our information security team takes care of these types of risks. They identify and classify these risks. We have physical security measures at the reception desk. Not just random selection, but each and every person has to have their bag checked before entering the premises and undergo a physical scan by metal detectors. Secondly, any type of equipment coming in or going out are scanned by metal detectors. We have CCT detectors and cameras in the server rooms and our server rooms are biometric, which means that access is allowed by scanning the index finger of the authorized person. Even the IT head cannot enter the server room without proper authority and reason. Regarding identity fraud, there is a card reader that reads the access card and cameras can see who has entered, if there is a problem the card is sent to the checker and even if the senior manager wants

to take a client to the server room, email permission is required which can be approved only by the IT head. The system is bureaucratic but it is required. If you go around the premises, you will see on each wing there is a lot of security because we protect our clients' information. We also feared that adjacent buildings could observe the goings-on of our organization and with the help of good technology and cameras, could take snap shots of the interiors. To avoid this risk, we have installed glass where outsiders cannot see what's going on in the organization. Back to information security, a lot of email sites are blocked and not everybody has access to the internet. Only senior management and process related people do.

Provider 2 elaborated the security procedures instituted by them to address concerns regarding privacy and security of information. They had similar provisions for information security as described by Provider 1 above. However, Provider 2 explained that assertions that data is safe and information security procedures are sufficient may not satisfactorily alleviate client concerns. The following excerpt describes the measures adopted by provider 2 to ensure safety of client information:

In order to mitigate client concerns regarding information security satisfactorily, we have gone for certification. Certifying mitigates at least 80% of clients' concerns. Along with certification, we have to be assessed with BSI which involves a lot of compliances from IT perspective, physical security perspective, business contingency plan, and disaster recovery. Next, the trick is how you maintain that. So we have periodical assessments done by the BSI at our cost to make sure we are still in compliance. Now this gives a lot of comfort to the client. Client XYZ is the best example. XYZ signed the contract with us 4 months ago after we got the BSI certification. They waited until we got the certification. It was of such importance to them. The certification is like a check list of all the areas that we need to be complaint with. BSI gave us 6 months. They take a look at each and every process and they tell us, here you are fine but here you have holes and you need to plug this and this is how you plug it and then they come back and reevaluate us. Finally their staff from UK comes down and does the final assessment of the entire process and then they certify us, so this is how it is taken care of. Moreover, assessments are done periodically. i.e. every six months... some companies do it on a yearly basis but our clients are not happy with that because they might say in 3 months you may plug out all the holes but what about the other 9 months the holes are exposed. Now we are doing it every 6 months. So at least we maintain those standards

So this takes care of security risk and business contingencies and disaster recovery, logical security in case of information systems, physical security, hacker prevention for data in case of health care clients, we provide training for HIPA compliance. So the client issue is paid a lot of attention.

Finally, the following excerpt describes the measures adopted by Provider 3 to ensure safety of client information:

The way we have tackled identity frauds and data base hackers is, we do not bring any data into the premises. We restrict printing. Our clients' premises are extremely paper based and the first thing we tell them is if you have to work with us, we will not be printing anything for you. We will be printing paper only if it is absolutely required and once the work is done, we will immediately shred the paper. There are clearly defined policies on printing and shredding. Secondly, no camera phones are allowed on the floor and no access is granted to 3rd party networks like yahoo or hotmail etc. Again, in some cases if the client is comfortable, they can provide access. The standard is that we do not provide it. We do not enable floppy drives nor do we enable our USB ports. The preferred mode is to work on CITRIX where we cannot store anything even on the local drives so we have shared drives at the client site. Everything is stored at the clients' site. We prefer not to store anything at our end. Further, we make sure that everyone understands their responsibility, the sensitivity around the data that they are handling and they understand what it is that they need to do. We have policies such as everyone has to swipe their card when they are getting in. We sensitize people to ensure they follow those policies and if they are not followed, there are rules for non-compliance. For e.g. we are handling client ABC's entire process and there is a lot of sensitive information. So if you come around at year end, or quarter end, or month end of ABC, nobody other than provider 3 employees that are dedicated to ABC's team are allowed, not even our managing director can enter the ABC floor. That is the kind of security we have.

The above discussion seems to corroborate the AICPA's assertions about security of data but we must bear in mind that the above providers are one of the fourteen leading providers in India. As specifically mentioned by Provider 1, security measures followed at other TPSP may not be identical or as rigorous as security measures in these organizations.

Trust issues within the members of expert systems:

Giddens (1990, p.87) notes that trust mechanisms do not relate only to the connection between lay persons and experts. They are also bound up with the activities of those who are "within" abstract systems. He argues that codes of professional ethics, in some cases backed by legal sanctions, form one means whereby the trustworthiness of colleagues or

associates is internally managed. Giddens emphasizes (1990, p.26) that all disembedding mechanisms, both symbolic tokens and expert systems, depend upon trust. Disembedding is explained as the “lifting out” of social relations from local contexts of interaction and reembedded in other circumstance thus allowing their migration to broader contexts. Reembedding here represents a means of anchoring trust in the trustworthiness and integrity of colleagues. The analysis of the trust relationships within the AICPA provides insights about trust and distrust relationships among different sub-groups. In the ensuing discussion, I draw on Giddens’ theoretical developments to problematize the linkages between the accounting experts and their system of expertise.

Offshoring of tax returns is a divisive issue among the accountants in US. The elites and the non-elites have systematically different agendas and perspectives, especially about the prospects of professional change. This is a clear feature of the peculiarly fragmented organization of the US accounting profession (Fogarty et al., 2006). Accountants working in industry have a different sense of their responsibilities than those working in large firms, who again have different values than those who work in smaller public offices or those in the public, voluntary or community sectors (Hastings and Hastings, 1970).). How practitioners come to see themselves, their identity as individual, public sector, or corporate accountants and auditors, and what this means in terms of their allegiances and concerns, inter-relate with regulatory processes and impacts how rules are operationalized (Cooper et al. 2006).

The AICPA has approximately 350,000 members. Forty nine comment letters were received in response to the exposure draft proposing revisions to the rulings. Members of small firms that do not outsource tax returns and non-practicing members criticized the

practice of offshoring arguing that it reduces the overall trustworthiness of the profession.

Concerns voiced by Corey Bidne, AICPA member were:

If this information is not disclosed to the client, I believe this issue is a time bomb waiting to go off. It is only a matter of time before clients discover that outsourcing to foreign countries is being widely utilized, which will add another scar to the public image of CPAs. As CPAs we are charged with restoring investors faith after the wake of Enron and MCI, telling clients upfront that a third party may be used as part of the process is a preventative measure that we should take”(Appendix D, AICPA 2004c)

Extending this view, Michael Cummins, CPA reasoned that:

I think a contractual agreement with a foreign entity such as a firm in India would not be possible to enforce as a practical matter. So I think any disclosure to a foreign entity should be required to be disclosed to a client (Appendix G, AICPA 2004c).

James Mckeown, CPA, stated that:

Disclosure to the client in "broad language" is unacceptable professional behavior. Also telling them a third-party "may be used," when one will be, is not the right thing to do (Appendix M, AICPA 2004c).

Lawrence Yoder, CPA, observed that:

So I am commenting that this exposure draft is too soft on the profession. We all know that outsourcing leads to more return for large firms while costing jobs here in America. Why not outsource locally? Not overseas (Appendix Y, AICPA 2004c).

The above excerpts from the comment letters are indicative of the negative sentiment shared by the members of small accounting firms towards offshoring of returns. In contrast to the position of the small accounting firms is the position of the large accounting firms, who are, not surprisingly supportive of offshoring practice and opposed to disclosure of the same. This stand was evident in the argument forwarded by LBMC, one of the largest regional firms in Tennessee which was also voted the 6th largest firm in the south-east and the 54th largest firm in the United States. LBMC strongly opposed the requirement describing it as an obstacle to practicing CPAs who are trying to be

successful and competitive and focusing unnecessarily on the negative. Says David Morgan, member of the LBMC team in his response to the exposure draft,

I am very concerned about anything that makes practicing CPAs non-competitive. On the one hand we cry about workload compression, not being able to find staff and working to many hours. On the other hand, we keep making it harder for practicing CPAs to be successful and competitive by constantly focusing on the negative (Appendix C, AICPA 2004c)

Supporting this argument was Warren Averett, the largest locally owned CPA firm in Alabama that has been ranked by many groups as one of the Top 100 CPA firms in the United States. In the past tax season they outsourced approximately 350 1040s and are planning to outsource approximately 500 to 750 returns in current year. Their response to the exposure draft read:

Because of the positive effect outsourcing has on our firm, the improved quality of work life it allows us to provide to our employees, the enhanced review capabilities that lead to a quality end product and the extreme security measures taken by outsource providers, we believe that there should be no additional disclosure required by firms that utilize an outsource service provider. It is further our opinion that the proposed changes to this rule will change the nature of the ruling from its original purpose of protecting consumers from having their data misused (Appendix MM, AICPA 2004c).

The AICPA in support of the large firms forwarded the argument that the disclosure of offshoring is counter-productive and impedes economic development. The AICPA explained that firms with global capabilities have adopted an entire range of sophisticated business protocols to ensure that they can enter and enforce an entire range of contractual obligations and duties. To suggest otherwise, particularly in the explicit fashion described by the proposed IRS revenue procedure is, to badly misrepresent the capabilities and motivations of the vast majority of firms engaged in providing tax services and filing support across international boundaries (AICPA, 2006). This argument

was evidenced by the following comment on the proposed IRS regulations, REG - 137243-02, requiring disclosure of offshoring of tax return preparation.

The AICPA is also concerned that the proposed regulations (as currently drafted) do not recognize or adequately reflect the various forms under which large accounting and legal firms are organized in today's global marketplace; a circumstance that complicates both the domestic disclosure and potentially the offshore disclosures. In this context, we believe the proposed regulations should be modified (for purposes of offshore disclosures) to permit the use of a consent embodied in the traditional engagement letter used by an accountant or attorney as opposed to the explicit consent otherwise required by prop. reg. section 301.7216-3 (AICPA, 2006).

The AICPA seems to be concerned about the complicated circumstances the large firms operate in and it is not clear how changing the form of disclosure will uncomplicate those circumstances. The above quote seems to be urging the IRS to skirt the issue by requiring the disclosure to be in a form that can be conveniently buried in the engagement letter or the tax organizer. Thus, the AICPA reproduces the front stage within the abstract system of the profession by managing the trust and distrust relationships between the small and large accounting firms to promote the overall trustworthiness of the profession.

The above analysis also brings forth the observation that a lay person's faith in expert systems would lead one to believe that the role of the revised ethics rulings is to consider service to the public as the dominant force guiding the performance of professional duties. The public view of the professional/client/public triad is one of professional obligation to present information in which the public can place its trust. If the public perceives, whether correctly or not, that the professional has allowed information to be presented which has slanted or shadowed the truth so as to render it less than trust worthy, the expectations of the public have not been met and there is the potential for a loss of trust in the profession (Lindblom and Ruland, 1997). In discharging their professional responsibilities, members may encounter conflicting pressures between the fulfillment of

the public interest and the private interest role of the profession. The revised ethics rulings further members' private interests providing testimony to the undeniable trend of commercialization of the accounting profession witnessed in the last decade.

Commercialization of the accounting profession

Hanlon's work on the role of accountants in the labor process of modern capitalism has the considerable virtue of raising often neglected questions about the profession as a business that pursues profit, and one that shifts its activities depending on the specific form that capital accumulation takes in different places and times (Hanlon, 1994, 1996, 1997). While Hanlon's work concentrates on the role of firms in commercialization, much of the literature on the accounting profession and commercialization has emphasized the role of professional bodies. Robson et al. (1994) extensively explore the ways in which British professional bodies articulated an increasingly commercial role for their members and how this interacted with their claims to be professional and acting in the public interest. Radcliffe et al., (1994) take the analysis further by pointing out that the UK professional bodies worked hard to construct themselves, at least discursively, as enterprising organizations. Finally, Hanlon (1998) has extended the argument about commercialization, by pointing out that the attempt to be 'enterprising' can result in serious cleavages in the service class. Since the demise of Arthur Andersen and the series of accounting scandals, debates about commercialization have intensified. Mitchell and Sikka (2004), Zeff (2003a, 2003b) and Wyatt (2004) claim that the commercialization of the Big Four went too far and regulatory structures are needed to curb past excesses.

Such debates emphasize the importance of further examining the practices of accountants and auditors, and not relying on the discursive claims of professional

associations and leaders of the industry that they are indeed professional (Simmons and Neu, 1997). It would be useful to examine whether claims to be 'gentlemanly' and professional values might be a strategy to be commercial. Appeals to such forms of social and cultural capital can be an effective strategy for professionals in developing their business and being profitable (Cooper et al., 1996). Rather than producing a conception that commercialization may be antithetical to professionalization, studies of accounting and audit practices will benefit from examining the work practices and client relations of professional organizations (firms and associations) (Cooper and Robson, 2006) and particularly how claims to be commercial and professional are selectively used in such organizations (Alvesson and Karreman, 2004). While current research focuses on historical analyzes, there is important work to be done in analyzing current developments, relating to the role of the accounting profession in commercialization (Cooper and Robson, 2006).

In this study, I analyze whether the underlying motivation of the accounting profession in revising the ethics rulings regarding disclosure of outsourcing is economic and commercial or is a proactive attempt at being genuinely ethical. The revised rulings contain ambiguous wording which can result in different interpretations to different readers. For example, the rulings do not reveal whether the return will be outsourced or offshored in any clear terms. Concerns regarding the format of the disclosure were brought forth in comment letters to the exposure draft. Adrian G. Lyman, CPA, stated in his letter to the AICPA (AICPA, 2004b):

In my opinion, the committee is too accommodating in its conclusion that "guidance concerning the use of third-party service providers should apply equally to service providers located both domestically and abroad." To conclude that the public, the best interests of which our profession still purportedly serves, will make no distinction

between domestic service centers and those located abroad is simply nonsense. Worse, it is a position which has potentially disastrous implications to the profession. The industry has taken some hits lately in consumer confidence, and the incomplete disclosures recommended by the foreign service centers offering off-shore "outsourcing" can only contribute to the perception that CPAs are more concerned about the letter of the law than its spirit.

Rodney S. Conant, CPA stated in his comment letter:

I was proud until I read how you propose to allow a member to disclose his use of "third-party providers." The use of the term "broad language," which would inform the client that "a third-party service provider may be used" is utterly whimpish. Why waste your time and member dues coming to that conclusion? If a client has a right to know, we should be honest and candid with the client. While the AICPA uses the term "transparency" and "clear understanding" with clients while addressing issues such as independence and peer review, why now are you taking a position that the form of disclosure could be buried in small print in a document that has other purposes. If we are to be "honest and candid" this disclosure should be obvious and clear. It should not be a part of an organizer or in the standard privacy policy letters that no one reads.

The language recommended in the revised rulings requires that the member 'should' and not 'must' disclose that a TPSP may be used thereby shifting the onerous concern of disclosing to the member's discretion. Further, the disclosure format requires that the member state that the return 'may' be outsourced to a TPSP. The disclosure is unintelligible since it enshrouds the AICPA member's intent to outsource and the identity of the TPSP. These observations are brought forth from close scrutiny of the following excerpt of the revised ruling 112:

Before disclosing confidential client information to a third-party service provider, a member *should* inform the client, preferably in writing, that the member *may* use a third-party service provider (AICPA, 2004a).

Curt Eakin, C.P.A., Chairperson of The Professional Conduct Committee of the California Society of Certified Public, voiced the committee's concerns regarding the disclosure format in their comment letter to the exposure draft:

We believe that the method of disclosure should not be left to the discretion of the member. If we, as a profession are to maintain integrity and objectivity in the minds of our clients and the public, we need to not hide the fact that we are using a third

party service provider. If we fear that this disclosure will drive away clients and therefore do not wish to make it known as a profession, we are not acting in the public interest.

In the revised ethics rulings, the AICPA asserted that offshoring does not result in release of confidential client information and thus should not require specific client consent. Although seemingly forthright, the AICPA's insistence on discouraging specific client consent signals an insidious agenda. On one hand, the AICPA upholds the profession's obligation to be candid and honest with the client and insists on the client's right to know if a TPSP is being used. On the other hand, the final rulings do not require specific disclosure of offshoring since the PEEC noted that they believed it was appropriate to focus on the ethical issues when a member uses the services of a TPSP and not to address the geopolitical concerns associated with outsourcing. Thus, the ruling merely called for disclosure in some general sense ("preferably in writing"). (Brody et al 2006). The above rationale does not address the fact that the geopolitical concerns themselves have ethical implications. The recommended disclosure withholds vital information about the geographical location of the service provider. The AICPA ensured that the revised rulings disclose as little information as possible in as vague terms as possible. The following excerpt from the exposure draft details the AICPA's claimed commitment to being honest and candid about any information shared with a TPSP.

The committee remains committed to the belief that disclosing confidential client information to third-party service providers used in providing a professional service to clients would not constitute a release of confidential client information, and thus not require specific client consent. The committee does however believe that a client has a right to know, and the profession an obligation to be honest and candid with a client, if the client's confidential information may be shared with an entity that is not under the member's or his or her firm's control, or with an individual not employed by the member or member's firm. Accordingly, the committee is proposing a requirement that a member disclose the use of third-party service providers utilized in the provision of professional services to clients (AICPA, 2004).

The above statement by the AICPA is unquestioningly motiveless and wholly representative of the AICPA's desire to serve the public better. Implicit in the AICPA's act though is the real motive that completely contradicts their assertions. The public interest ideal is being touted to buy legitimacy for its activities so that the activities can continue unaltered. The AICPA wants to continue outsourcing the returns to a foreign country and has once again marginalized public interest in the face of members' self-interests. The AICPA's concern with sustaining business practices and with uncomplicated procedures for disclosure of offshoring is also evidenced in their response to the proposed IRS regulation for disclosure of offshoring of tax returns. In REG-137243-02, the Internal Revenue Service proposed amendments to the regulations under Internal Revenue Code (IRC) section 7216. Section 7216 imposes criminal penalties on tax return preparers who make unauthorized disclosures or uses of information furnished to him or her in connection with the preparation of an income tax return⁶ (IRS, 2006). The IRS revision to the proposed regulations has raised a furore for a number of different reasons among a number of different groups. The consumer groups believe that requiring specific consent would result in release of confidential client information instead of the intended effect of safeguarding the client's privacy. The proposals have set off some apparently unexpected protests from several consumer protection groups, basically concerned that the proposals make it too easy for taxpayers to unknowingly grant permission for disclosure of their tax information.

There have been suggestions that the proposed revenue procedure was influenced by lobbying from major tax return preparation companies. Critics of the proposal, including

⁶ See IRS Notice 2005-93, Internal Revenue Bulletin No. 2005-93, page 1204. Notice 2005-93 is also found at irs.gov at the following URL: <http://www.irs.gov/pub/irs-drop/n-05-93.pdf>

the U.S. Public Interest Research Group, the National Consumer Law Center and the Consumer Federation of America, focus on the possibility that taxpayers very often do not read every document that is put before them in the tax preparer's office. They are concerned that taxpayers will be unwittingly signing away disclosure of some of their most confidential personal and financial information. (Jones and Luscombe, 2006)

Not surprisingly, the major consumer-based tax return preparers who will benefit from the sale of this data (such as H&R Block and Jackson-Hewitt) have remained quiet. No doubt, they hope this issue gets no more attention than the misleading IRS announcements expect to receive. No one should sign consent to have one's tax information used by others (Nolte 2006).

Amid the outburst of reactions of various parties to the IRS proposal, the AICPA's reaction to the proposal is noteworthy. The AICPA, unlike the other agencies, did not object to the form of the suggested IRS disclosure. The AICPA objected to the very fact of requiring disclosure deeming the IRS's measures as extreme and unnecessary. The AICPA submitted Comments to the IRS on March 8, 2006 on "Proposed Regulations, REG-137243-02: Regarding Guidance to Facilitate Electronic Tax Administration- Updating of Section 7216 Regulations". This document is particularly incriminating and brings forth the duplicitous approach being adopted by the AICPA to address the offshoring disclosure issue. The AICPA recommended that, instead of the regime outlined in the proposed regulations, the IRS incorporate in the final regulations, the approach the AICPA has adopted for its members. Specifically, as described in their June 6, 2005 letter to IRS Commissioner Mark W. Everson, the AICPA mentioned that it had adopted two new and one revised ethics rulings, regarding a CPA's responsibilities

when outsourcing services to third-party service providers whether domestic or offshore.

The AICPA stressed that their provisions provide a more balanced approach for protecting taxpayer information while accommodating modern business practices (AICPA, 2006):

In contrast to the requirements set out under prop. reg. section 301.7216-2(d), the AICPA's ethics rule on outsourcing does not require the preparer to obtain the written consent of the taxpayer prior to any disclosure to another preparer. While we are conceptually supportive of the IRS's underlying policy goals with respect to protecting the confidentiality of a taxpayer's tax return information, especially when involving the disclosure of tax information to a preparer located overseas, we believe the AICPA ethics rules (regarding outsourcing services to third-party service providers) are more in line with modern business practices than what is provided for under prop. reg. section 301.7216-2(d) (AICPA, 2006).

Thus, the AICPA's heightened concern with being commercial than professional once again reveals their modernizing ambitions taking precedent over their public interest role.

Summary and Conclusions

The primary aim of this study was to examine the commercialization of the accounting profession using Giddens (1990) theory of trust and expert systems and Parker's (1994) private interest model in the context of the AICPA's revised ethics rulings regarding the disclosure of outsourcing of tax return preparation. The paper draws on evidence regarding the revision of the ethics rulings 12, 112 and 1 under rule 102, 201 and 301 respectively. This encompassed examining the discourse surrounding the revision of the rulings using media coverage and AICPA and other regulatory agencies' pronouncements and augmenting this examination with in-depth interviews conducted with top management members of three leading TPSPs located in India. This investigation allowed me to scrutinize whether the disclosure recommended in the

revised rulings is adequate and serves the public interest claims made by the AICPA. This study adds to the stream of research (O'Dwyer, 2003) that represents a direct response to Sikka's (2001, p759) call for instigation of research "which scrutinize the rhetoric and public interest claims of accountancy bodies". Further, this examination addresses Cooper and Robson's (2006) observation that, rather than producing a conception that commercialization may be antithetical to professionalization, studies of accounting and audit practices will benefit if work practices and client relations of professional organizations are examined.

In this study, three issues that are identified as problematic in the revised ethics rulings are analyzed. The first issue which is the AICPA members' furthering their private interest over the public interest is interrelated to the second issue which is the resulting loss of trust in the accounting profession. The AICPA members can advance their private self-interest over public interest only to the detriment of the trust that is vested in the profession (Brien, 1998). One may argue that the AICPA's decision to offshore returns without client consent is only an attempt to use their expertise to make decisions in lieu of their clients who do not possess the knowledge, expertise or requisite information to make their own decisions. By doing so, the AICPA members are engaging in professional paternalism. Paternalistic behavior toward an individual is philosophically undesirable because it restricts the individual's autonomy and the individual's ability to make informed decisions (Dwyer and Roberts, 1998). The AICPA's refusal to disclose information about the geographical location of the TPSP represents unjustified professional paternalism. Moreover, refusal to disclose this information can also be

interpreted as mystification of these practices arising from a self-interested need to maintain secrecy.

Analysis of the public interest role of the AICPA versus private interests was done with the help of Parker's (1994) private interest model of professional accounting ethics. The AICPA revised its new ethics rulings to serve its private interests roles which are ensuring professional insulation, facilitating interference minimization, exerting self-control, maintaining professional authority and preserving socio economic status. The AICPA's proactive attempt to revise the ethics rulings evidences the desire of the AICPA to invoke the professional insulation and self-control role of ethical codes. The analysis brought forth the AICPA's preoccupation with preserving the socio-economic interests of its members along with other latent objectives such as interference minimization and professional insulation to help promote their professional authority. However furtherance of members' private interest will lead to impairment of trust in the accounting profession and the resulting loss of public confidence draw our attention to the fact that the profession is not invulnerable to scrutiny or immune from accountability and stands to face consequences for pursuing unethical behavior.

Thus, the second issue, public confidence in the accounting profession and possible impairment of trust is understood in terms of work by Giddens (1990) and his discussion regarding trust issues between lay persons and expert systems and within members of profession. This examination brings forth the observation that a lay person's faith in expert systems would lead one to believe that the role of the revised ethics rulings is to consider service to the public as the dominant force guiding the performance of professional duties. However, the revised ethics rulings further members' private interests

providing testimony to the undeniable trend of commercialization of the accounting profession witnessed in the last decade which is the third issue identified in the study. The public interest ideal is being touted to buy legitimacy for its activities so that the activities can continue unaltered. The AICPA wants to continue outsourcing the returns to a foreign country and has once again marginalized public interest in the face of members' self-interests. As stated by Jim Rigos, CPA in his comment letter to the exposure draft:

For once we had the chance to be on the right side and demonstrate that the AICPA serves the public interest by being ahead of the curve. I am disappointed (AICPA, 2004c).

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CHAPTER FOUR: STUDY THREE: SUSTAINING COMPETITIVE ADVANTAGE IN FINANCE AND ACCOUNTING OUTSOURCING MARKETS: A CASE STUDY OF LEADING THIRD PARTY SERVICE PROVIDERS

Introduction

Business Process Outsourcing (BPO) refers to the transfer of the optimization and management of one or more information intensive business process to an external provider, who, in turn, owns and administers the selected processes based on specific performance criteria (Mani et al., 2006). BPO is a heterogeneous and rapidly growing offshore market with a projected annual growth rate of 60 percent (Tapper, 2004). Brown and Stone (2004) reported that BPO accounted for 34 percent of the global outsourcing contract value in 2004 and projected that BPO services would grow from \$1.3 billion in 2002 to \$4.3 billion in 2007. Growing organizational investments in BPO provide testimony to the strategic role played by BPO in modern business practices. In less than half a decade, offshoring of BPO, particularly to India, has risen dramatically as the industry has gone from its infancy to the second largest and single fastest growing industry in India (Aron et al., 2005).

When a company embarks upon the preliminary assessment stage of what to outsource, functions such as IT, Human Resources, and Finance are often outsourced together. Frequently, IT and Human Resource functions are outsourced first followed by finance and accounting (Finance and Accounting Outsourcing Market Review Report, 2006). Although outsourcing of routine accounting functions is gaining momentum, the passing of the Sarbanes- Oxley Act (2002) has engendered uncertainty among the top

executives in finance departments because of its increased emphasis on financial controls, making it imperative to reconsider the functions that should be outsourced. The Finance and Accounting outsourcing (hereafter FAO) markets, being in their nascent stages, are confronted with unique constraints and risks that are absent in mature IT outsourcing markets (Masur, 2006). A survey by the Economist Intelligence Unit conducted on behalf of Accenture Finance Solutions determined that greater emphasis on corporate governance and increased direct control of finance processes was acting as a deterrent to outsourcing of finance functions. (Accenture finance solutions Report, 2004).

Due to the recent wave of high profile accounting scandals such as Enron, MCI WorldCom, business executives have heightened their concern towards the completeness and accuracy of the financial reports that they publish (Defond et al., 2005). There are, consequently, serious apprehensions about FAO due to the increased possibility of loss of control, which in turn could weaken corporate governance and result in breaches of compliance with regulatory requirements. This argument may lead one to conclude that FAO may not be the optimum alternative in the long run, reducing its significance to a fad. On the other hand, statistics indicate that the global FAO market has grown by more than forty-five percent since the beginning of 2005 and is predicted to grow in excess of thirty percent in 2007 (www.faoresearch.com)⁷. In this study, I maintain that this growth

⁷ FAO Research, Inc. is the only research firm worldwide focused exclusively on the Finance & Accounting Outsourcing (FAO) market. Headquartered in Cambridge, Massachusetts, FAO Research provides in-depth market research, custom analysis and consulting services to outsourcing service suppliers to help with critical decisions associated with their FAO business issues. With frequent publishing of reports and independent, unbiased viewpoints, FAO Research is a trusted source for impartial research and opinions. For more information, visit www.faoresearch.com.

stems from the visualization of potential value of FAO and will be sustained by attending to the factors that may impede its realization.

The FAO market is grossly under-penetrated across all regions and verticals, and there is still substantial opportunity for growth (www.fao.com) provided the service providers take into account the costs and risks that are faced by their clients and are able to deliver valued services (Levina and Ross, 2003). The advent of FAO is indicative a recent development which may permanently alter the manner in which financial reporting is performed in the US. New regulatory requirements such as the Sarbanes-Oxley Act and new practices such as outsourcing and offshoring will intertwine to reconstruct an environment of unexamined practices (Mani et al., 2005). FAO may strongly influence the choice of future organizational form and structure thus making it important to develop an early understanding of this industry. In this study, I develop a theoretical model that examines the factors that enable service providers to maintain market share by recognizing the issues that endanger the survival of FAO and developing competencies to address these issues. In doing so, I examine issues that have received little prior theoretical or empirical attention.

The method adopted in my study is theory generation in the manner written by Glaser and Strauss (1967), Mintzberg (1979) and Miles and Huberman (1984) based on case study evidence of three leading FAO service providers in India. The three cases were selected from a list of fourteen suppliers (www.fao.com) in order to facilitate the analysis of different organizational cultures, operating models, and success stories among the leading service providers and interviews were conducted with top management personnel. The analysis of data entails constant comparison of data and theory in order to

develop adequate conceptual categories. Table 8 describes the analytical processes associated with each level of output.

Table 8. Data analysis phases

Level	Dimension	Description
Within-case analysis	Factors that individual service providers consider as their competitive advantage. (Firm-level Drivers)	Description of the firm-level characteristics that help the firm to gain an edge over its competitors. Identify Key success factors that provide the firm with competitive advantage.
Within-case analysis	Factors that are identified in extant literature that will determine the survival of FAO in the long-run. (Industry-level Drivers)	Four factors were identified from literature: Emphasis on client's corporate governance, Emphasis on Compliance, Risk Management and Competition. Service providers rate industry-level factors based upon their assessment of the level of importance that can be attributed to that factor in ensuring the survival of the industry.
Cross-case analysis	Cross-case comparison between Firm-level drivers	Comparison of factors within firm-level drivers that provide competitive advantage to individual service providers to search for commonalities and differences in competitive strategy.
Cross-case analysis	Cross-case comparison between Industry-level drivers	Comparison of factors within Industry-level drivers that provide competitive advantage to individual service providers to search for commonalities and differences in ratings attributed to factors.
Sharpening constructs and verifying relationships	Developing comprehensive framework to explain the factors associated with sustaining competitive advantage in the field of FAO	Based on the within case and cross case analysis, an overall framework will be proposed.

Within-case analysis was conducted for the first case study in order to become intimately familiar with the case as a stand-alone entity. The other two case studies will be analyzed in a similar manner followed by a cross-case analysis across all the three case studies. Cross-case search for patterns will consist of searching for within-group similarities coupled with inter-group differences across the categories to develop a comprehensive framework of factors that are necessary for sustaining competitive advantage in FAO markets. This study is interesting for several reasons. First, no published work to date explicitly examines the factors that lead a service provider in the FAO market to sustain its competitive advantage (Kremic et al., 2006). In the last fifteen years, academic research on IS outsourcing has evolved rapidly. However, the vast majority of this research examines issues of interest to the buyer of outsourcing services rendering research undertaken from the service providers' perspective to become notably scarce (Dibbern et al., 2004). There is a dearth of studies in outsourcing that attempt to address the service provider's perspective (Levina and Ross, 2003; Goles, 2001)⁸. Also, studies generally explore IS outsourcing not finance and accounting (Dibbern et al., 2004).

Second, sources of sustained competitive advantage for firms have been studied extensively in the field of strategic management (Porter, 1985; Rumelt, 1984). There is lack of research that conceptually explores the competitive advantage construct in the

⁸ The study conducted by Levina and Ross (2003) explored the vendors' perspective using the theory of core competency, concept of complementarity in organizational design and findings from the literature on vendor-client relationship to understand how vendors provide value to their clients through outsourcing. Goles (2001) explored the vendors' perspective by conducting a survey based study of outsourcing that proposed that higher vendor-client alignment, teamwork, balance of control, and process agility in the relationship will lead to more successful outcomes.

outsourcing literature. FAO markets are unique as they face regulatory constraints and governance requirements. Providers that attempt to succeed in these markets must possess certain attributes that are not possessed by the other firms in the same industry as well as similar firms in other industries. An analysis of the competitive advantage construct in FAO markets will provide useful insights to service providers and their clients into factors that drive the growth of FAO markets. Finally, this study specifically analyzes the performance of service providers in FAO markets in India. Many countries around the world are emerging as FAO service providers such as China, the Philippines, Hungary, the Czech Republic and several Latin American countries. However, the research site is based in India since India is the world's leading offshore outsourcing destination (See Table 9). India's revenue from BPO operations is expected to grow from approximately \$1 billion in 2002 to \$13.8 billion in 2007, and its share of supply is projected to be 57 percent of the offshore BPO market (Scholl et al., 2003).

Table 9. India's competitive position relative to other countries

Country Ratings	India	China	Israel	Africa	Ireland	Ireland	Republic	Poland	Hungary	Russia
Government Support	E	F	G	F	VG	VG	P	F	F	P
Labor Pool	E	G	G	F	G	G	F	G	G	VG
Infrastructure	F	P	VG	F	VG	VG	F	F	P	P
Education System	VG	F	VG	G	VG	VG	G	G	F	VG
Cost	E	E	F	VG	G	F	VG	G	VG	E
Political Stability	F	F	P	F	G	E	VG	G	F	F
Cultural Compatibility	F	P	VG	E	E	E	VG	VG	VG	G
Data/IP Security	G	P	VG	G	E	E	F	F	F	P
Overall Climate	VG	P	F	F	G	G	F	F	P	P

Note: P = Poor; F = Fair; G = Good; VG = Very Good; and E = Excellent.

Source: Gartner (2004).

The remainder of the paper is organized as follows. In section 2, I provide a background of the growth of the FAO markets and the competitive advantage construct. In section 3, I elaborate my choice of methodology for collecting and analyzing the data. Section 4 presents a within-case analysis of the three service providers which is followed by a cross-case analysis in order to build a comprehensive framework for understanding the sources of competitive advantage for the service providers. Section 5 provides a description of the conceptual framework while section 6 provides a summary and conclusion.

Background

Immaturity of FAO Markets and factors essential for success

The Finance and Accounting outsourcing (hereafter FAO) markets are immature and face constraints and risks that are not faced by IT outsourcing markets (Masur, 2006). Findings from the core competency literature seem to suggest that the finance function should not be outsourced. Efficient firms allocate their own resources to those activities within the value chain for which they enjoy a comparative advantage over competitors (Shank & Govindajaran, 1992). Though there is debate in the outsourcing literature regarding the precise definition of a core function, there is widespread agreement that how core a function is should have a bearing on whether or not to outsource it (Quinn, 1999; Drtina, 1994). Quinn suggests that those activities, usually intellectually-based service activities or systems, which the company performs better than any other enterprise are core (Quinn, 1999).

Activities that are not core competencies should be considered for outsourcing with best-in-the-world suppliers, though some non-core activities may have to be retained in house if they are part of a defensive posture to protect competitive advantage (Gottschalk and Solli-Saether, 2005). The above argument supports the proposition that accounting and finance are functions that should be kept in-house even though they are not core functions, due to their proximity to the core⁹. Another consideration for keeping the accounting and finance function in-house is the rising costs of outsourcing. The increased governance and compliance issues faced by the public companies impose greater costs to the buyer. Moreover, measuring accounting activity is complex, since the quality and quantity of service output are difficult to quantify as compared to operational activities with dedicated inputs and more tangible outputs. The multiple common resources used in accounting to provide a variety of accounting outputs make the capture of complex interactions and outputs difficult enough to inhibit outsourcing (Barrar et al., 2002). Accounting researchers recently have argued that companies are overly committed to outsourcing and underestimate potential drawbacks due to transaction costs (Chalos, 1995).

The growth in organizational investment in BPO is marked by an accompanying increase in dissatisfaction with BPO (Mani et al., 2005). A study conducted by Deloitte consulting contends that participants initially engaged outsourcers to cut costs, simplify project execution, and provide expertise they lacked in-house. Instead of simplifying operations, the study says, many companies have found that outsourcing activities can

⁹ According to John K. Halvey, renowned sourcing advisor and Partner at global law firm Milbank, Tweed, Hadley & McCloy LLP "The closer you get to the core of the operation, the harder it is to get the decision made to outsource...and you don't get much closer than the finance function which is why this market has taken longer to evolve than some other BPO areas."

introduce unexpected complexity, add cost and friction into the value chain, and require more senior management attention and deeper management skills than anticipated (Chabrow, 2005). The aftermath of poor BPO performance is usually the transference of the failed outsourced operations back in-house. However, the economic ramifications of such failed BPO relationships are pronounced, including potential adverse impact on customer value and overall firm competitiveness.

Mani et al. (2005) conducted a study that emphasized that developing an understanding of the drivers of BPO performance, including why certain outsourcing arrangements fail to deliver value, is critical because not only is the use of BPO rising across industries, but also firms' boundary choices are increasingly shaping their competitive positions. They stressed that BPO performance stems, not necessarily from an inappropriate vision of potential value, but from the lack of attention to the right business model that will help realize value which is the bane of the survival of the outsourcing practice. This paper adopts a similar approach only focusing the lens specifically on BPO of finance and accounting services to determine the unique challenges faced by them.

The Competitive Advantage Construct

Alderson (1965) was one of the first to recognize that firms should strive for unique characteristics in order to distinguish themselves from competitors. He stated that differential advantage might be achieved through lowering prices, selective advertising appeals, and/or product improvements and innovations. A firm is said to have a competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors (Barney,

1986). A firm is said to have a *sustained* competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy. Some authors have suggested that a sustained competitive advantage is simply a competitive advantage that has lasts a long period of calendar time (Porter, 1985). In this study, I use the term ‘sustaining’ competitive advantage since the on-going growth and infancy of the FAO markets may make the advantages gained by service providers processual and vulnerable to depletion.

Research Methods

In the present study I use case studies of three leading BPO service providers to develop a grounded theory about the factors that enable service providers to enhance firm performance. This approach is considered most appropriate in the early stages of research on a topic. When little is known about a phenomenon, theory building from case study research is most appropriate because theory building from case studies does not rely on previous literature or prior empirical evidence (Eisenhardt, 1989). An initial definition of the research question, in at least broad terms, is the first step in Eisenhardt’s (1989) approach towards building grounded theory from case studies. The primary research question that guided the interviews in the study was to determine the principal factors that are instrumental in providing FAO service providers with the means to sustain their competitive advantage. The definition of a research question within a broad topic permits

investigators to specify the kind of organization to be approached, and, once, there, the kind of data to be gathered (Pettigrew, 1988; Leonard-Barton, 1988).

Although early identification of the research question and possible constructs is helpful, it is important to note that both are tentative in this type of research (Eisenhardt, 1989). The topic under consideration was researched by asking questions to members of the management in their natural settings, by means of what Yin (1984) termed multiple case design. Such a design allows me to follow a replication logic (Yin, 1984), whereby multiple cases are treated as a series of experiments, each case serving to confirm or disconfirm the inferences drawn from previous ones. This study was undertaken with no theory under consideration and no hypotheses to test, an ideal in theory building research (Eisenhardt, 1989).

Site Selection

Selection of cases is an important step in theory building from case studies (Eisenhardt, 1989). The three cases were selected from a list of fourteen suppliers in order to facilitate the analysis of different organizational cultures, operating models, and success stories among the leading service providers. The selection involved constraining the population to large corporations operating in specific type of environments in order to reduce extraneous variation and clarify the domain of the findings. The FAO Research, Inc. compiled a list of fourteen service providers based on the criteria that full-scale FAO services were provided on a global basis for a number of years and strong growth in the FAO arena was demonstrated by winning multiple, brand-name engagements over the past two years (Ross, 2006).

The criterion for ranking the largest players in the market was their dominance in serving segments of the FAO markets. Although, measuring the providers by FAO revenues, number of F&A transactions processed, number of clients served, or staff size should offer a fair snapshot of their position in the market place, it may not be an accurate basis for ranking the providers (FAO today, 2006). The reason is the providers listed occupy a unique stratum in the marketplace. Some are high-volume execution machines that process billions of transactions a year for their clients. Typically leveraging their IT heritage, these global companies provide FAO through a business process outsourcing unit, which itself might be a small portion of the overall business. They are market leaders in various respects from the total value of transactions processed to the number of service centers they operate and the number of workers employed. Conversely, there are providers who can be described as niche players since they focus on a particular function or industry.

The majority of these fourteen suppliers offer FAO services globally, seek business from the Fortune 500/Global 1000 and serve multiple industries. The provision of BPO services comprises a major portion of their business, with FAO positioned as a key contributor to their future successes. The fourteen most significant F&A outsourcers on a global scale are listed in Table 10.

Table 10. List of fourteen largest FAO service providers

Name of Provider	Revenues (2005) (Amounts in US dollars)	Staff Size	Number of countries in which the company is present	Ownership Status
Accenture	16.65 billion	146,000	49	Public (ACN)
ACS	5 billion	55,000	100	Public (ACS)
EDS	20 billion	100,000	60	Public (EDS)
ExlService	95 million	5000	15	Private
Genpact	135 million	19000	8	Private
Hewlett-Packard	85.2 billion	4000	50	Public (HPQ)
IBM	88.3 billion	6000	48	Public (IBM)
OPI	Not available	1000	2	Private
Perot Systems	1.8 billion	17,000	20	Public (PER)
Progeon	75 million	5700	8	Private (Infosys Public: INFY)
TCS	2.24 billion	400	10	Private (Public in India)
Wipro	1.5 billion	42,000	23	Public (WIT)
WNS	165 million	9000	3	Private
Xansa	130 million	13,000	40	Private (Public in India)

They have a long track record of providing outsourcing services and possess strong capabilities surrounding risk management, contract governance, process transition, systems management and processing expertise. They differ in many ways and have unique strengths and cultures that make them the strongest candidates to win FAO engagements (Ross, 2006).

Specifically, the research site is based in India since India is the world's leading offshore outsourcing country (Mehta et al., 2006, See Table 9). In 2003, India accounted

for 75 percent of total BPO offshore delivery value, a value that is expected to increase by 55 percent annually over the next five years (Neale, 2004). India's revenue from BPO operations is expected to grow from approximately \$1 billion in 2002 to \$13.8 billion in 2007, and its share of supply is projected to be 57 percent of the offshore BPO market (Scholl et al., 2003). According to a recent McKinsey analysis, India was nominated as the top location of choice for companies wishing to outsource their business processes based on consideration of two primary parameters. Firstly, people attractiveness such as size of talent pool, salaries, quality, and knowledge and comfort in English and secondly, location attractiveness such as infrastructure availability, bandwidth availability, electricity availability, political stability, government policies, and time zone differences (Patni, 2003).

Data Sources

The primary source of data employed in this study to facilitate theory-building were semi-structured interviews. The managers of three leading FAO service providers were interviewed with the aim of establishing differences or similarities in the strategies pursued by them to sustain their competitive advantage in the field of FAO. An interview questionnaire was developed for the study. Its contents were based on a conceptual framework developed prior to data collection. A conceptual framework explains, either graphically or in narrative form, the main things to be studied, the key factors, variables or constructs and the presumed relationships among them (Miles and Huberman, 1984).

The framework isolated factors that were identified in extant literature as necessary for the survival of finance and accounting outsourcing and predicted that presence of these factors would provide a service provider with a competitive advantage.

The questionnaire consisted of twenty six open-ended questions (See Appendix C). In addition, since this was an inductive study, I pursued any unexpected but interesting lines of discussion. The interviews were tape recorded and transcribed. The typical interview was sixty minutes; the length varied from thirty minutes to ninety minutes. Members of the top management team as well as managers at operational levels were interviewed. The interview began with asking the interviewee to identify and describe the primary factors that, in their opinion, contribute to maintaining their company's competitive advantage as compared to other firms in the field of finance and accounting outsourcing.

The interviewee was encouraged to exhaust all the factors to their knowledge before moving to the next question. Next, the interviewees were given a list of factors identified through extant literature as areas of concern that must be attended to in order to ensure the longstanding success of FAO providers. These factors emphasized a client's corporate governance, compliance, risk adversity, and competition. The factor emphasizing client's corporate governance consisted of sub-questions that probed a deeper understanding of the service provider's approach in developing a well documented plan to understand and address every individual client's corporate governance mechanisms (See Appendix C). The questions were aimed at understanding whether the service providers were making any conscious attempts at improving their client's quality of financial reporting and whether there was an emphasis on building long-term trustworthy relationships with the clients. The second factor, compliance, aimed to understand the procedures that were in place to dispel the client's fear that outsourcing could lead to breaches of compliance with regulatory requirements, particularly the Sarbanes Oxley (SOX) Act requirements.

Questions were also asked to determine if the provider had any SOX related compliance measures in place. The third factor, client's risk adversity consisted of questions that were directed at determining the specific risk reduction strategies that were adopted by the service provider to mitigate client's risks associated with outsourcing their finance and accounting functions. The primary areas of concern identified were client's fear of loss of control associated with outsourcing financial reporting and information security risks. Lastly, questions about the fourth factor, increased competition, were asked to gather information about strategies adopted by the service provider to cope with future competition from other low-cost countries. The managers of each company were asked to rate the four factors based on the level of importance attributed by them to each factor based on its ability to provide the service provider with a competitive advantage. The factors were rated on a scale of 1-3, 1 being very important, 2 being somewhat important and 3 being not important at all. Copies of presentations and policy manuals or any other documentation supporting the discussion were requested.

Qualitative Analysis

The method of analysis used in my study draws on descriptions of how to generate grounded theory (Glaser and Strauss, 1967; Mintzberg, 1979; Miles and Huberman, 1984). The analysis of data entails constant comparison of data and theory in order to develop adequate conceptual categories. An important assumption underlying the method is that human creativity and intuition is required to develop data into theory (Mintzberg, 1979). As an investigator travels back and forth between theory and data, some initial ideas can be grounded in the evidence, others may be modified considerably on the basis of evidence, and still others may be abandoned for lack of evidence

(Mintzberg, 1979). This is the approach followed in analyzing data and generating theory in the present study. A within-case analysis of the first case study was conducted in order to become intimately familiar with the case as a stand-alone entity (Glaser and Strauss, 1967). A similar analysis will be conducted for the two remaining case studies as well. Conducting a within-case analysis allows the unique patterns of each case to emerge before the patterns can be generalized across cases. It also enables the researcher to gain a rich familiarity with each case which, in turn, accelerates cross-case comparison.

The first step of the within-case analysis involved a latent content analysis of the transcripts of the interview data. Interviews, field notes, videotapes, and open-ended questions have been content analyzed to make inferences and develop new theory about a number of interesting organizational and managerial topics, including competitive actions (Birnbaum-More & Weiss, 1990). According to Berg (1989), latent content analysis represents an interpretive reading of the symbolism underlying the physically presented data and thus focuses on the deep structural meaning conveyed by the message. The next step entailed organizing the analyzed data into a conceptually clustered matrix with the rows and columns arranged to bring together items that belong together (Miles and Huberman, 1984). The categories were constructed based on comparisons between extant literature and data at hand to identify the various factors that lead to sustaining the provider's competitive advantage (See Table 4). Each column represents a factor that underlies the competitive advantage construct.

Once within-case analysis of all the three case studies was completed, a cross-case analysis was conducted. Cross-case search for patterns will consist of searching for within-group similarities coupled with intergroup differences across the categories.

Cross-case analysis will be conducted using a mix of variable oriented and case oriented approaches. In a variable-oriented analysis, one would read the table vertically, focusing on variables and their relationships and look for themes that cut across cases. In a case oriented analysis, a theoretical framework is used to study one case in depth, and then successive cases are examined to see whether the pattern revealed matches that in previous cases (Yin, 1984). Combining the two approaches will result in stacking the case-level matrix in a meta-matrix which will then be further condensed, permitting systematic comparison (See Table 11).

The Study

Sources of competitive advantage: Firm Level Drivers

Provider One Case Analysis

In order to maintain anonymity, the service provider in the first case study will be referred to as Provider One. Provider One began as a small venture in 1988 and now it is a premier provider of diversified BPO and information technology outsourcing solutions to commercial and government clients worldwide. Provider One is a Fortune 500 company of more than 58,000 people supporting client operations reaching nearly 100 countries. Provider One provides its clients with superior BPO services including administration; finance and accounting; human resources; payment services; sales, marketing, and customer care; and supply chain management. Their world-class ITO offerings include applications solutions; data center management; disaster recovery; end-user computing; network management; security services; storage solutions; technology review, assessment, and planning; and transition services for human resources. My

analysis of the transcribed interviews with the Provider One management enabled me to identify the factors that the top management considers as the main differentiators that Provider One possesses enabling it to achieve its competitive advantage.

Table 11 lists the factors and their classification into the relevant sources of competitive advantage based on criteria identified in extant literature.

Table 11.Sources those are instrumental in sustaining competitive advantage in Finance and Accounting Outsourcing Markets

Provider One				Provider Two				Provider Three			
Human Capital	Strategic Business Units	Organizational Design	Proprietary Technology	First to Market	Deep Domain Expertise	Proprietary Technology	Knowledge Integration and Transformation	Reputation and corporate image	Deep Domain Expertise	Customized Risk Management	Internal Benchmarking
People's Skills are a source of competitive advantage. Performance based pay systems are used.	Runs on a business unit concept. Each country for a particular company is treated as a separate business unit	Flexible organizations mandate that business processes are integrated end-to-end, enabling it to respond with flexibility and speed to any customer demand	Proprietary Software developed in-house for the past fifteen years provides clients with considerable savings.	The first mover can shape consumers' perceptions to its advantage, attain critical sales volumes and accumulate valuable research	The knowledge and skills embodied in the employees of an organization are often viewed as strategic assets	Provider Two leverages their company's extensive technology capabilities in financial platforms to deliver integrated business solutions	Achieved through a process known as 'Lifecycle Management' which involves partnering with customers throughout the outsourcing process	Industry leadership and proven track record provide them with a competitive advantage	Provider three considers domain knowledge and industry expertise as a source of their competitive advantage	Provider Three has a dedicated team of risk management specialists who focus only on managing risks for their clients' offshore programs	Committed to improving its client processes through continuous improvement projects designed on the basis of the Six Sigma framework

The construction of categories helps in developing a classification table that is empirically grounded to help us understand how a firm achieves and maintains its competitive position in the market. An initial examination of the transcripts generated a list of factors that indicated the presence of firm-level effects as well as industry-level effects on firm performance. There are two opposing schools of thought that deny the possibility that firm as well as industry level effects can be simultaneously present. Firm effects and industry effects capture the degree of heterogeneity within an industry. They underlie several important concepts in strategic management such as distinctive competence and competitive advantage. Firm effects capture the unique firm characteristics which influence the variation in strategies and performance outcomes across industries and firms, and industry effects refer to attributes common to an industry.

Yet two schools with significant influence in strategic management have been at odds with one another regarding the magnitude and persistence of firm effects. The resource-based view argues that firm heterogeneity is significant and persistent, whereas industrial organization suggests that industry effects dominate over time. The resource-based view explains the firm effects on strategies and performance outcomes within the same industry (Wernerfelt, 1984; Barney, 1986; Peteraf, 1993). However, industrial organization researchers argue that the common structural elements of an industry lead its members to share competitive characteristics. Thus, as successful firms develop resources producing competitive advantage, other firms are able to reduce competitive gaps by imitating these valuable resources. As a result, convergent patterns of competition can become common industry characteristics over time (Cohen and Klepper, 1992; Kotler 1994).

Mauri and Michaels (1998) conducted a study that argued that the above two hypotheses underlying resource-based view and the industrial organization schools within strategic management are complementary. Industry-level drivers that promote homogeneity coexist with firm-level drivers that generate heterogeneity, just as various forms of competition coexist within the same industry. Firms invest upfront in resources that permit differentiation from their competitors. However, as industries evolve, imitation reduces the gaps and differences in resources between firms (Demsetz, 1973). Mauri and Michaels (1998) results support the complementarities between resource-based and industrial organizations perspectives. A number of studies support the above findings (Roquebert et al., 1996; McGahan and Porter ,1997; Chang and Singh, 2000).

This theory provides a basis for understanding the emerging complementarities that was noted between the firm level and industry level drivers of the competitive strategy pursued by Provider One. Probing into strategic management literature revealed a body of evidence that addresses the complementarities between firm and industry level drivers of competitive advantage (Mauri and Michaels, 1998; Roquebert et al., 1996) confirming that they can co-exist and are not mutually exclusive. The list of factors that were identified as competitive advantage for Provider One was then further categorized into firm-level drivers or industry-level drivers of competitive advantage.

Strategic Business Units

The resource-based view (RBV) of the firm suggests that strategic deployment of capabilities allows strategic business units (SBUs) to exploit distinctive competencies and create sustainable competitive advantage. That is, the capabilities themselves help the SBU perform better, but performance is further improved for SBUs that have abilities to put these capabilities to best use. The SBUs that best develop and manage their resources and capabilities through time will outperform their competitors (Hitt and Ireland, 1985). The RBV defines capabilities as bundles of skills and knowledge that allow SBUs to make best use of the assets they possess and to efficiently coordinate their activities (Day, 1990). SBU specific capabilities are deeply rooted in the SBU's routines and practices and therefore are usually difficult for competitors to imitate (Dierckx and Cool, 1989). These SBU specific capabilities are the SBU's main source of long-term competitive advantage and performance.

Managers at Provider One claim that one of the greatest sources of competitive advantage is that the organization is designed as a complete matrix organization with multiple SBUs. SBUs help instill entrepreneurship to optimize client service. It also facilitates clear financial accountability and visibility, dedicated resources, proven industry and process expertise, flexibility to grow with the business and tailored solutions. The Director of F&A at Provider One elaborates on this differentiator:

There are opportunities to grow in fact, ours is a complete matrix organization. Multiple strategic business units. More than 40 strategic business units that are operating in our Bangalore and Cochin locations. So, All these 40 SBUs belong to five major what you call as towers. Finance and Accounting is one of them. Through the F&A you have client related SBUs like ABC Inc¹⁰. So people have the opportunity to work from one SBU to the other in order to gain more experience and to understand the process flow. Even if they don't like F&A, if

¹⁰ Names of service provider's client organizations are not revealed to ensure anonymity

they have reached their peak and feel the need to understand something else, they do get an opportunity. But we make sure that for a minimum of a year they work in the same SBU so one can ensure whatever was gained in training is paid back to the client.

Further elaborated by their CEO,

I think we just discussed the SBU Concepts as a major differentiator. I think most of our competition does not have the SBU concept. They have the shared services concept where they will be able to utilize the resourceslet's say F&A, or HRO to multiple clients through which obviously there are cost savings but what we have is....we excel in whatever we are doing specifically for our clients. So it's almost like we give the feeling to the client that we are the true extension of their existing team within the organization. They don't feel that it has been outsourced to somebody like Provider One and in fact the Provider One employees feel like they are ABC Inc. employees.

Proprietary Technology

Technology that can be kept proprietary has also been suggested as a source of sustained competitive advantage (Porter, 1980). Although proprietary technology can be protected through patents or secrecy (Porter, 1980), IT applications are difficult to patent (Jakes and Yoches, 1989). Moreover, even if they could be patented, there is evidence that patents provide little protection against imitation (Mansfield, 1985). Thus, secrecy is the only alternative for keeping IT proprietary. Clearly, if a firm possesses valuable proprietary technology that it can keep secret, then that firm will obtain a sustained competitive advantage. However, most research indicates that it is relatively difficult to keep a firm's proprietary technology secret, and thus, it is unlikely that proprietary technology will be a source of sustained competitive advantage.

A wide variety of factors act to reduce the extent to which proprietary IT can be kept secret. Workforce mobility, reverse engineering, and formal and informal technical communication all act to reduce the secrecy surrounding proprietary technology

(Lieberman and Montgomery, 1988). Stated differently, while a particular firm may gain a temporary competitive advantage from its proprietary IT application, competing firms are usually not disadvantaged in imitating that technology by history, causal ambiguity, or social complexity. Provider One maintains that it possesses proprietary technology that provides it with a competitive advantage but whether it can keep the technology a secret will determine the permanency of this competitive advantage. But presently it is treated as a competitive advantage for Provider One as explained by the Director of F&A:

Technology – we have developed our own in house proprietary tools over the past 15 years which specifically works for BPO operations. In the process, what we have done is, we have improved the processes of each steps as it is taken. We automate it as we go along and we bundle those tools to our clients and we don't charge anything for that. For example, in some instances, we took out file length system for one of our clients which cost us 6 to 8 million dollars and we installed our own imaging system which generated a lot of savings for the client. So, technology is something we keep abreast of, on the BPO side that applies specifically to F&A. A good example would be ODM. It is an Online document management system which is a workflow. It is a proprietary work flow and that is a differentiator for our organization.

Organizational Design

The management literature argues that flexibility in organizations can enhance corporate responsiveness and can create competitive advantages. Flexibility is the ability to respond appropriately to a wide variety of business conditions. Flexible organizations mandate that business processes are integrated end-to-end, enabling it to respond with flexibility and speed to any customer demand, market opportunity or external threat (Shi and Daniels 2003, Sethi and Sethi 1990). Becoming flexible is becoming an imperative for survival. There are several dimensions to becoming a flexible organization including the following: creating a responsive internal environment that can quickly react to any change in the marketplace, planned or unforeseen, a threat or an opportunity. Second, an

organization should have variable cost structures to manage costs in proportion to growth of the organization or change in demand. Third, an organization needs to be focused on what is profitable and core to the enterprise's success. Finally, the organization needs to have a resilient infrastructure that is available around the world and around the clock (Phan, 2001).

The CEO of Provider One claims that size and flexibility are major differentiators for their company. The organizational structure is a matrix consisting of SBUs that are modeled around the needs of individual clients. This form enables expansion or reduction of business activities based on the client base of the business and provides a great deal of flexibility. Performance based compensation systems are designed to promote variable cost structures and global delivery models provide the infrastructure that provides geographical representation in every country of the world. Shifting operations to low-cost countries provides the flexibility needed to adjust to a shift in demand or any other extenuating conditions. This sentiment amplified by the CEO of Provider One in the following statement:

On the differentiator, Provider One is always considered a low cost option. We are flexible. We are not too huge to be inflexible and at the same time we are not too small to be insignificant for our client. We are somewhere in between. We are 5 billion dollar company, 55,000 people, present in 400 countries. We are nimble, we are flexible to our clients. We cannot say that this is how we work guys and you either take it or leave it. We don't do that. We say ok this is how we provide service to our clients. We are flexible in terms of deliverables to our client. Being smaller that makes it easier and being smaller also helps .. People are more dedicated to their jobs and they are considerate.Personal organization.

Human Capital

Firms create value through either decreasing product/service costs or differentiating the product/service in a way that allows the firm to charge a premium

price (Barney and Wright, 1998) Thus, the ultimate goal of any HR executive is to create value through the human resource function. The HR executive must determine the manner in which the HR function can aid in either decreasing costs or increasing revenues. The CEO of Provider One claims that one of its major differentiators is the talent pool represented by its employees. Pay-for-performance is being more widely adopted because it provides a means of focusing performance on the accomplishments of business objectives, thereby increasing employee morale and controlling costs. As evidenced in the following statement by the CEO of Provider One:

It goes all the way from keyer to all the way up to me for instance and even the management staff we are on performance based compensation but the percentage might vary. Like let's say keyer may be paid 50% of base salary and rest of the 50% based on the performance. They get better all the time. Their output is much higher than normal what you would have seen in the traditional way and they are making money too. So, the productivity goes up and their earning goes up. One of the reasons for our attrition rate to be lower. Right, that's a major differentiator. Performance based compensation.

Thus, the HR function in Provider One is designed to add value by decreasing attrition costs and boost revenues by improving output and is a source of competitive advantage for Provider One.

Further, in order for any characteristic of a firm's human resources to provide a source of competitive advantage, the firm must be organized to exploit the resource (Barney and Wright, 1998). An organization should have in place the systems and practices that allow human resource characteristics to bear the fruit of their potential advantages. The employment mode, the employment relationship and HR practices in place at Provider One bear similarities to characteristics displayed by firms in Quadrant 2 of the HR architecture derived by Lepak and Snell (1999). Lepak and Snell (1999) drew upon several works in economics, organization theory, strategic management, and HRM

literature to develop the foundation of a HR architecture that aligns different employment modes, employment relationships, HR configurations and criteria for competitive advantage.

Human capital in Quadrant 2 is valuable, yet widely available throughout the labor market and skills in this quadrant are not unique or specific to a firm. Hence, managers may be hesitant to invest in internal development of skills because employees with generic skills may leave and transfer the organization's investment to another firm. A problem common to BPO service providers who complain about attrition rates as high as 70-80%. Provider One reconciles these conflicting pressures by acquiring from the market human capital that does not require further investment. Consequently, the employment mode adopted at Provider One is the acquisition mode which enables firms to reap the benefits of valuable skills that have been developed elsewhere while holding them internally. In so doing, the acquiring firm simply pays the value reflected in the market price and realizes immediate benefits vis-à-vis productivity (Becker, 1976).

The employment relationship for employees and organizations in Quadrant 2 is symbiotic employment which means it is based on the utilitarian premise of mutual benefit (Tsui et al., 1995). In essence, a symbiotic relationship rests on the notion that both the employees and the organization are likely to continue the relationship as long as both continue to benefit. Such a relationship is reflected between Provider One and its employees through its performance based pay systems. Finally, the HR configuration at Provider One is market based which means it is likely to include externally equitable wages. Provider One describes itself as a good paymaster that is capable of attracting

people with skills to join the company. The Vice-president of Provider One reiterates this argument in the following statement:

People come from there to here, people go from here to there. We are very competitive in pay. Our rates are somewhere around 75th to 78th percentile in the industry. So, we are not low pay masters and we are not high pay masters either.

Provider 2 case analysis:

First to Market

There is strong theoretical and empirical evidence supporting the idea that "first-to-market" leads to an enduring market share advantage (Rahman and Bhattacharyya, 2003). A first mover can be formally defined as a firm "that is first to produce a new product, use a new process or enter a new market" (Lieberman and Montgomery, 1990). A large number of papers discussing the relative advantages of a first mover have been published in management journals. These papers suggest that though a first mover may not benefit from spectacular gains, it certainly enjoys several competitive advantages. (Robinson and Fornell, 1985; Robinson, 1998; Rogers, 1983; Tellis and Golder, 1996). Consumers may pay more attention to a first mover over a late entrant since, in the early stages of market evolution, consumers have minimal knowledge about the ideal product attributes and their ideal combination. Consequently, the first mover can shape consumers' perceptions to its advantage, attain critical sales volumes and accumulate valuable research and development and market experience before any other competitor. It may reap benefits from cost advantages associated with scale and experience economies (Rao and Rutenberg, 1979; Simley and Ravid, 1983). These cost advantages may be utilized either to achieve higher margins or lower product prices to discourage competitors from entering the market. Additionally, a first mover can secure patents and

pre-empt domination of distribution and communication channels (Rahman and Bhattacharyya, 2003).

Provider Two initiated the discussion regarding the factors that differentiate their company from their competitors by identifying the company's approach to entry in the BPO market. At a time when the competitors forayed into BPO with the intent of capturing market share in call center outsourcing, Provider Two positioned their entry at a higher point allowing them to straddle the value chain. They predicted that as the industry matures, future growth of BPO would comprise transaction processing thus providing them with a position of advantage in a market with high exit barriers and greater profit margins. The following statement by the head of Solution Design and Implementation (SDI) for the F&A function of Provider Two elaborates their strategy as explained above:

We started our operations in April 2002 and we started most of the companies were going after the call center business so there were 10000 people good revenues but for us that was an industry with no exit barriers and high profit margins so at that point of processing kind of business and then we consciously decided to stay away from the call center business so our philosophy at that point of time being we will go at a higher point we will go into transaction processing and if there is any quality requirements managing transaction process we will do that so our focus was at managing transaction process if you see the industry started off here and right now has moved to here which is high exit barriers and more complex functions and we directly started work in this area. It is not that we do not have call centers we do have call centers but it's about 20% of our revenues

Deep Domain Expertise

Knowledge and information are among the most important sources of competitive advantage and success an organization can have (Turner and Jackson-Cox, 2002).

Employee know-how, innovative capabilities and skills play a predominant role in defining the productive power of an organization (Quinn, 1992) accounting for an

increasing proportion of an organization's capital, even in traditional industries (Sveiby, 1997). As Coff (1997) observed, the knowledge and skills embodied in the employees of an organization are often viewed as strategic assets. The combined intelligence, skills and expertise possessed by the people within an organization lend it a distinctive character. The first step required to measure the store of knowledge embodied in an organization is to understand the composition of each individual's explicit, or domain, knowledge. Despite individuals being significant sources, conduits and generators of knowledge, the quantum of organizational knowledge is not just simply the aggregate of each individual employee's domain knowledge (Howells, 1996). Knowledge creation within an organization centers on the crucial presumption that human knowledge is created and enlarged by means of social interaction. This interaction converts the domain knowledge of individuals into collective structural and procedural, or tacit, knowledge within the organization (Nonaka and Takeuchi, 1995). From an organizational perspective, this form of knowledge has a more permanent dimension and the organization may build on it a sustainable competitive advantage.

Provider Two states that developing 'Deep Domain Expertise' and 'Centers of Excellence' are one of the key differentiators for their organization. Provider Two's F&A practice is built on an in-depth understanding of the finance & accounting domain. Their employees and managers are recruited from finance and accounting backgrounds and are continually exposed to current and emerging best practices. They claim to have a Finance & Accounting Center of Excellence to centralize and advance specialized domain knowledge across individuals and customer engagements through extensive training and certification programs. As stated by F&A head of solution design and implementation:

Provider Two has always focused on developing deep domain expertise and that is what we have also focused on for F&A we have come up with Center Of Excellence which starts by training our people for making sure they are ready for working on client engagements which means everything that comes ...

One of the other things that is a key differentiator is the transaction expertise the biggest challenge that we think you would place in any outsourcing engagement is the transition because if there are any problems which is not taken care of during transition or if the transition is not done well, you would be saddled with an engagement that will be deprived of the profits throughout the engagement life. You would have an unhappy client, you would have an unhappy associate because even if they are working to their best they would not be meeting the clients expectation and it would eat into the management profits at both locations: the clients and on our end.

Proprietary Technology

As elaborated under the Provider One case analysis, technology that can be kept proprietary has also been suggested as a source of sustained competitive advantage (Porter, 1980). Provider Two leverages their company's extensive technology capabilities in financial platforms to deliver integrated business solutions. Provider Two has also tied up with best-of-breed vendors to deliver leading edge F&A focused technology solutions to their clients. Provider Two's proprietary methodologies like nFlux (Biz-IT alignment), Proton (Operations improvement), InFlow (Infrastructure management) help it achieve continuous improvement and transformation

One of our differentiators is technology solution and ERP (Enterprise Resource Planning). we have the best practices implemented from our parent company which helps us to come up with process improvement ideas which can be immediately rolled out to the clients with minimal time spent going back and forth, whether something is doable or not. In certain areas where parent company does not have capabilities or did not develop capabilities things we have gone ahead and struck deals or made alliances with a leading independent solution providers. So far, we have alliance with Bottom Line Technologies which is a leader in procurement to pay solution.

Knowledge Integration and Transformation

Firms of even moderate size and scope must address the problem of integrating contributions from multiple specialty areas. Moreover, firms are beginning to appreciate the benefits of close interactions with suppliers, partners, and customers throughout the value stream (Carlile and Reberich, 2003). The currency of these interactions and communication is information, at the least, and more likely complex forms of specialized knowledge. As the scale and scope of the integration task increase—perhaps as a result of product complexity, technical advances, or the difficulty of the regulatory environment—a firm's effectiveness in knowledge integration (Grant 1996) will distinguish it from its competitors. Many organizations face competitive environments where novelty is high and the nature of the product or service creates many dependencies and differences. These situations are more challenging because increasing novelty creates the need to transform knowledge (Carlile 2002). Integrating and transforming knowledge is a cyclical process that requires adaptation and transformation (Carlile and Reberich, 2003). For an organization to effectively integrate knowledge in complex settings in the long term, it must build the capacity to manage knowledge storage, retrieval, and transformation over multiple cycles.

Provider Two describes knowledge transformation and integration as one their major differentiators. They describe this process as 'Lifecycle Management' which involves partnering with customers throughout the outsourcing process in a structured and transparent process that proceeds in three phases—Discovery, Transition, and Steady State Operations. The first stage, discovery, requires companies considering business process outsourcing to look beyond the obvious cost arbitrage and address several enterprise-wide issues such as the regulatory and operational risks, ensuring lack of

business disruption, estimating the amount of investments needed in technology and determine procedures for management of change. Lastly, companies must gauge their readiness to assume change. Provider Two's 'Discovery' stage helps their customers find answers to these and similar questions over a four to six week period.

The second stage, described as 'Transition' is a ISO (International Organization for Standardization) certified transition methodology which is based on successfully transitioning over 500 company owned or third-party provided processes across multiple geographies and languages. Provider Two also reverses transition processes. Provider Two's transition methodology is divided into three phases, planning, execution, and parallel run and managed through four tracks, program management, knowledge, operations, and technology. This matrix ensures that processes are migrated rapidly and smoothly. The third stage, 'Steady State Operations', involves continually monitoring remotely running processes through online portals, and through daily, weekly and monthly calls to ensure two-way communication to flag and manage issues. Provider Two has a structured escalation matrix and process for dispute resolution and routinely runs quality improvement initiatives under the Six Sigma framework and commits to ongoing yearly efficiency improvements on all data processes. The above process was described by the principal consultant in F&A function of Provider 2:

We have our sales organization which primarily pursues the client, kind of introduces the concept to them and what we can do. But basically my team works with the sales team to understand the client's requirements, for instance, what is the road map to achieve their stated goals, what are some of the processes you should be look to outsource, how you would go about outsourcing. Thus, we are actively involved in the sales cycle and once the deal is finalized, my team takes over. In terms of our transformation process, we say there are three steps of transformation and we pride ourselves on being a transformation BPO.

Provider 3 Case Analysis:

Reputation and Corporate Image

Corporate audiences routinely rely on the reputations of firms in making investment decisions, product choices and career decisions (Dowling, 1986). Reputations signal publics about how a firm's products, job, strategies and prospects compare to those of competing firms. Favorable reputation can therefore generate excess returns for firms by inhibiting the mobility of rivals in an industry (Caves and Porter, 1977). Wilson (1985) confirmed that a firm's reputation is an asset that can generate future rents. Reputation building behavior is strategically important in incomplete information settings (Weigelt and Camerer, 1988).

Provider Three claims that their industry leadership and proven track record provide them with a competitive advantage. Their business leaders are experienced outsourcing industry professionals from global companies. They have an exceptional track record of attracting and retaining senior talent with both global exposure and domain expertise to meet our clients' unique business needs. They have a history of success and high recognition, growing from a single-client organization to a leading pure-play BPO provider with more than 100 clients and a ten-year record of running critical business operations for global corporations in diverse industries. They are regularly placed at the top of several industry rankings. These rankings range from top performers in the Indian offshoring industry to best rated human capital development practices globally.

Deep Domain Expertise

Similar to Provider two, Provider three considers domain knowledge and industry expertise as a source of their competitive advantage. They strategically focus on select industries and invest proactively to strengthen our competencies in these segments. Our industry focus has yielded significant dividends in terms of growth and market leadership has led them to be ranked amongst the leading global players in finance and accounting services. They claim that their focus has helped us develop deep domain expertise to become true partners for their clients. Their domain knowledge is also reflected in the wide range of industry-specific, specialized and complex processes they carry out in out focus industries.

Customized Risk Management

Risk management has been described as one of the factors that will be crucial to the growth of F&A (FAO, 2005). Provider Three states that risk management poses a different set of challenges for a client planning an offshore capability. It is important for global companies moving operations offshore to be assured their processes will continue to run in the event of a disaster, their information is secure and they are complying with all regulatory requirements. Provider Three visualizes risk management as a factor that will provide it with a competitive advantage. Provider Three has a dedicated team of risk management specialists who focus only on managing risks for their clients' offshore programs. The team engages with the clients early in their offshoring process to understand how various processes impact the client's business, assess criticality of the offshore operations, and design cost effective solutions to mitigate risks. Utilizing a proprietary model, Provider Three plans and provides back up capacity in the centers to meet the business continuity requirements of the clients. Information Security is assured by assessing the inventory of information assets, testing their vulnerability and establishes controls to ensure clients' data and Provider Three's own confidential and sensitive data is protected. Provider Three follows the BS7799 standard for its own

information security. In addition, specific security controls are built to suit individual client needs. The Associate Vice-president of Provider Three reiterates the importance of the risk management factor in the following statement:

I would rate risk management in the days to come as one of the most important factors because unless the suppliers become adamant at managing the clients risk and not the suppliers risk they are not going to get any competitive advantage

Internal Benchmarking

To translate knowledge into value organizations need to focus. O'Dell (1998) suggests that there are three reasons why this is critical. First, focus ensures that valuable resources are applied to high payoff areas. Second, focus helps ensure that the right knowledge is being acquired and transferred as well as demonstrating the need for this activity. Third, focus gets the attention of management and funding. Management's attention is diverted to success within their organization or competitor organizations, a compelling competitive need and demonstrated results. Three themes are evident in all successful internal benchmarking and transfer efforts. First, internal transfer is a people-to-people process; relationships seem to precede and to be required for meaningful sharing and transfer. Second, learning and transfer is an interactive, ongoing, and dynamic process that cannot rest on a static body of knowledge. Employees are inventing, improvising, and learning something new every day. The wellspring of best practices need never run dry. Third, specific skills and capabilities are needed as a foundation (Dell , 1988) California management review for reference)

Provider Three claims that one of its key differentiators is their continuous improvement focus. They are committed to improving its client processes through continuous improvement projects designed on the basis of the Six Sigma framework. It is

presently running several Six Sigma projects that lead to cost savings ranging between 30-60% for its clients. In addition Provider Three regularly seeks opportunities to increase process efficiency through redesign and application of technology tools. Provider Three works with clients to understand their business drivers, analyzes its transactions to generate relevant management information and share it with clients to jointly evaluate new improvement opportunities. Provider Three has transferred several client processes from time and materials-based billing to transaction-based pricing, which allows it to vary costs based on volume. By using a proprietary variance tree to monitor productivity across the client programs, clients are encouraged to use a similar model for their offshore initiatives. This model focuses on measuring and monitoring the fundamental performance metrics that determine the success of the program and reveal the underlying factors that lead to improved performance levels.

Sources of competitive advantage: Industry Level Driver ratings for all three providers

The following four industry-level factors presented in Table 12 were identified from extant literature at the outset of data collection and the interview questions were designed to address the importance of these factors in gaining competitive advantage in FAO markets. The interviewees were asked to rate the factors based on the level of importance attached to these factors in ensuring the survival of FAO markets in the long run, 1 being very important, 2 being somewhat important and 3 being not important at all.

Table 12. Industry-Level Drivers Ratings by Top Management

Industry-level Drivers	Provider One rating*	Provider Two rating*	Provider Three rating*
Emphasis on Corporate Governance	2	1	2
Emphasis on Compliance	2	1	2
Risk Management	1	2	1
Increased Competition	1	2	1

* The ratings are based on a scale of 1-3, with 1 being very important, 2 being somewhat important and 3 being not important

Risk Management

Outsourcing a critical process is risky, and risk analysis begins by attempting to understand the risk profile, or specific risks associated with outsourcing a particular process (Aron et al., 2005). Greater requirements to educate buyers on risks, perceived and real, of outsourcing could impede the FAO businesses of service providers (Finance and Accounting Outsourcing Market Review Report, 2006). Service providers must communicate the risk free nature of offerings to the buyers. They must identify the specific risks and controls on a process by process basis and maintain these controls to the level specified by the client. Risk management consists of three closely related actions: risk identification, risk analysis and risk control Risk identification is identifying risks that confront a system or project. Risk analysis is analyzing data collected about risks, including the impact and probability of occurrence. Risk control is identifying and verifying the existence of measures to lessen or prevent the impact of a risk.

There are many potential risks confronting outsourcing agreements. These risks can fall into one of three categories: legal, operational, and financial. After identifying the risks, the next action is to determine their relative importance to one another and their respective probability of occurrence. There are three categories of controls: preventive, detective, and corrective. Preventive controls mitigate a threat from exploiting the vulnerabilities of a project. Detective controls disclose the occurrence of an event and preclude similar exploitation in the future. Corrective controls require addressing the impact of a threat and then establishing controls to preclude any future impacts. In FAO markets, the prime risks are confidentiality and security of data and fear of loss of control over processes (Finance and Accounting Outsourcing Market Review Report, 2006). Risk reduction strategies involve getting certifications that ensure that certain procedures are in place. Mitigating physical risks and all other kinds of risks through certification gives the client a sense of comfort. The Vice-President of Provider One explained:

We are a BSI 7799 certified organization which stands for British standards for Information Security. Certifying mitigates at least 80% of their concerns. Not only do we get certificated but we have also have to be assessed with BSI. There are a lot of compliances from IT perspective, physical security perspective, business contingency plan, and disaster recovery. Now the trick is to maintain that. So we have periodical assessments done by the BSI at our cost to make sure we are still in compliance. This process gives a lot of comfort to the client.

The second major risk identified in FAO is fear of loss of control over functions that are close to the core. The clients that have been with the company for a number of years are reasonably comfortable and knowledgeable about the security of data and control over processes. Provider One has systems that ensure that the client still maintains control on quality standards by conducting their own audits. Outsourced operations are

subjected to regular monthly, quarterly audits and soft compliance reviews. The Director of F&A testifies to the fact that loss of control is not a major concern for their clients:

No they do not lose control at all and that is the reason they have these multiple audits taking place particularly Client X... Client X being our major client they put their own quality people on our floor. We have given them space. They are on Client X rolls but working with us. Client X wants to make sure that they have control over their matters

Further, Provider One's management asserts that clients need not fear the loss of control because outsourcing of financial reporting simply involves the conversion of client data into information. The decision making power remains with the company's management.

Some companies may look at it as a fear of loss of control but some companies may think of it as a practical and strategic matter because they could say that I cannot make a sense of the 10 sheets of data sitting in my office but if somebody can make sense of that data and pick out the information and tell me in one page on a daily basis where my business is at, I may love that. They still don't lose control over the organization. We are only doing transactional work by converting data into information and giving them decision making capability. We don't make the decisions for them.

Thus, alleviating client risk adversity is recognized by Provider One as an important factor that will ensure survival of FAO markets and is rated as 1, i.e. very important, by members of top management team. Provider Two recognizes fear of loss of control as one of the major impediments to the growth of F&A outsourcing. The head of F&A solution design and implementation explains his concern below:

I think the biggest block we faced with outsourcing was the perceived loss of control. Yes that's exactly what I was talking about. So I say it's a perceived loss of control because whether we do it here or people do it over there. In fact, the way we do it is a lot more structured and a lot more controlled since we are bound with high service levels whereas if they were doing it internally they would not have any service levels to achieve.

However, Provider Two rates risk management as 2, somewhat important. As stated by a top management team member of Provider Two

Now clients risk adversity is something I would say, is still very important but if I were to compare it to the first two factors (Emphasis on corporate governance and compliance) its not that important because if you have taken care of the first factor and the second factor, in some respects you have taken care risk management as well. So the rating would be 2.

Provider Three lists the same reasons as provider one and rates this factors as 1, i.e. very important explaining that managing risk will be a key factor in gaining a competitive advantage in the future years. As stated by the Associate Vice-president of Provider Three:

I would rate that as 1 in the days to come because unless the suppliers become adamant at managing the clients' risk and not the suppliers' risk they are not going to get any competitive advantage ...

Emphasis on compliance

The Sarbanes-Oxley (hereafter SOX) rules require public companies to report on the strength of their internal financial-reporting controls, to better prevent fraud and to ensure accuracy of financial filings. The FAO providers have to familiarize themselves with the varying degrees of SOX compliance demands which vary extensively from client to client. From an overall management system perspective, the implications of the SOX requirements are quite similar to other quality and regulatory requirements. They contain well-defined management system and processes, proactive approach to problem and risk management, clearly defined responsibilities for implementation, and self-assessment and appropriate checks and balances. If the provider has to sustain its competitive advantage, it will have to establish clear lines of accountability and conduct periodic compliance review of controls.

Service level agreements will have to be established that support defined processes and key compliance requirements. These steps will lead to an outsourced environment that seems to provide more clearly defined and transparent business processes than the in-house processes that have evolved over time. Director of F&A recognizes SOX compliance as important and agrees that perceptions regarding the failure of a company to be able to meet SOX requirements have to be managed in order to ensure the long term success of FAO. Emphasis on SOX compliance is rated as 2, which it is considered somewhat important by majority of the members of the top management team of Provider One. However, Provider Two rates this factor as 1, reinforcing the argument that it is extremely important. As stated by the senior manager at Provider Two:

If you talk about F&A outsourcing you would typically see not a lot of activity happening in the last quarter because everybody is focusing on maintaining SOX compliance and SOX compliance is something that nobody can afford not to maintain. It is definitely one of the key factors that are on everybody's mind when outsourcing their process... I would rate this factor as 1.

Provider Two explains that SOX compliance is a factor that can provide competitive advantage because it has aided the outsourcing of F&A rather than impede it. This argument is explained below by the F&A Head of Provider Two:

It's not a block. In fact, we welcome SOX because what it has done for us is, it has brought some level of documentation into our clients' organizations. Four years ago, if you went to the client's organization you had to start from scratch to understand how the processes were done since nobody understood how they were done. So, it actually has introduced a well defined process of checks and balances which is similar to what we do in an outsourced environment. So I wouldn't say regulatory issues with SOX compliance has impeded us or stopped the outsourcing but it has in a way helped in increase the outsourcing.

Provider Three, in agreement with Provider One states that SOX compliance is a factor that should be treated as a given. It is a factor that may not bestow a competitive

advantage but may be necessary to ensure the very survival of the industry. Therefore, it is a factor that will become common to all providers of F&A and it should be rated as a 2 in terms of providing a competitive advantage.

Emphasis on Corporate Governance

One of the greatest challenges facing the BPO providers is the increased regulatory requirements around FAO. FAO providers will have to overcome a number of challenges in order to build customer confidence in their capabilities. There has been considerable debate in recent times concerning the need for strong corporate governance (McConomy and Bujaki, 2000), with countries around the world drawing up guidelines and codes of practice to strengthen governance (Cadbury, 1997). The underlying reason for this emphasis lays in concerns over the integrity of securities markets (Millstein, 1999). The accounting profession has been proactive in attempting to improve audit quality by issuing standards focused on discovery and independence. For example, in the United States (US), greater responsibility for the discovery of fraud has been placed on the auditor by the issue of SAS no. 82. Independence has received the attention not only of the profession but also of regulators and stock exchanges around the world (Goodwin and Seow 2002).

FAO service providers have to assure their clients that they understand the risks faced by the clients due to increased regulatory requirements and are committed to working with the clients to solve related issues. The service provider will be able to sustain its competitive advantage if it can establish an effective, long-term relationship which can lead to a trusted advisor status. At Provider One, emphasis on client's corporate governance is considered an imperative that is treated as a given and therefore

is rated as a 2 since it will not provide a competitive advantage to the firm in the long run. Attempts are made to cultivate long term relationships with clients and trust evolves over a period of time. The top management teams classifies it as a factor that is basic to the survival of the company and describes it as a basic building block without which it would be difficult to operate. Provider Two rates this factor as 1 and considers it very important. Finally, Provider Three rates this factor as 2 since they do not believe it will provide them with a means to gain a competitive advantage. The associate vice-president vocalized this argument in the following paragraph:

I see that these factors are becoming very important and a lot of clients will consider when deciding to choose a particular supplier, corporate governance and emphasis on compliance aspect. Now competitive advantage, I really don't know if you get a competitive advantage through a governance structure because it's kind of a given, I would say ... it is basic. If you don't have it, you are not worth being in this game at all.

Increased Competition

Increased competitive requirements to capture new FAO customers in a market that is still immature yet growing at a healthy rate worldwide could impede the FAO businesses of service providers (Finance and Accounting Outsourcing Market Review Report, 2006). India has dominated the outsourcing market but is now facing competition from China, the Philippines, Hungary, the Czech Republic and several Latin American countries. Service providers must pay attention to their competitive landscape in order to sustain their competitive advantage in the FAO industry. However, competition is a factor that was rated as 2, that is, somewhat important by Provider One for two reasons. First, according to them, the market is large enough to accommodate all the players thereby enabling them to maintain their current market share. Second, the problem of competition from low cost countries is already combated by adopting an organizational

structure consisting of global delivery models which allow them the flexibility to operate from the lowest cost center demanded by the client. As stated by the CEO,

Depending upon where you would the client would like their operations to be based, we could do that for them. If they want us to be based in china we have a center in china, if they want us be based in Malaysia we have a center in Malaysia and if they want us to be based in Kochi, where the labor cost is the lowest, we can do it there. If cost is the only criteria for them, we can take them to the lowest cost center. If they are looking for something beyond cost, say, a knowledge process outsourcing kind of operation, we can do it in some other country where cost would not be as cheap but their ultimate goal can be achieved. If opportunity arises and there is a huge cost difference we can capitalize on it. So, instead of expanding our operations in India we could expand in that country. This seems to be becoming a strategy for each of the service providers. Today Global Delivery Models have to be adopted by any organization. Only then, can you be competitive.

Similarly, Provider two rated competition as 2. Provider Three, on the other hand rated competition as 1 and considered competition as a factor that may provide them with a competitive advantage.

Environment and Strategy: A conceptual framework

After conducting the within-case analysis and cross-case comparisons, the emergent theory comprised varying managerial perceptions of industry level factors and consequently, varying competitive strategies. The distinctive competencies of each of the three providers differed with the exception of a few parallels that could be drawn. A set of research questions suggested itself from the foregoing. For example, does every firm have an objective environment that places constraints on the way it operates, i.e. an industry group has certain technical characteristics that must be attended to. Further, which perspective of the construct of 'environment' is most relevant to the current study, the industry-level drivers treated as objective characteristics of the environment or manager's perceptions of environmental characteristics? Also, does the managers' perception of the environment have an impact on

strategy formulation within the firm? My reading of the interview transcripts brought forth three important observations: top management executives of all three providers agreed that the four industry level drivers identified by me were important industry characteristics, their perception of the degree of importance that should be given to each of these four characteristics differed, the strategies pursued by each provider to develop distinct competencies in order to gain a competitive advantage varied with the exception of one or two factors that were common within the providers. In order to investigate the above stated research questions, I further interpreted the narrative developed in prior phases and linked it to conceptual ideas derived from the data and to wider theoretical debates in the literature. I read and reread interview transcripts to link empirical evidence to recurring themes and develop new themes.

Finally, I compared my grounded framework to various theories from economics of organization and strategic literature, treating them as another data set and doing comparative analysis as suggested by Glaser and Strauss (1967). The analysis involved consideration of various management perspectives on strategy formulation, external environment and the treatment of these factors in the business policy and organization theory literature. I concluded that the concept of integration of strategy and environment (Bourgeois, 1980) along with Dill's (1958) definition of the components of top management's task environment provided the greatest conceptual insights in analyzing how a provider develops and sustains its competitive advantage.

According to Bourgeois (1980), strategy can be sub-divided into primary (domain selection) and secondary (competitive approach). The concepts of strategy and environment are integrated in that primary strategy concerns opportunities in the general environment and

secondary strategy involves navigating within a task environment. Bourgeois (1980) argued that strategy content and environment have been joined empirically but there has not been much work that joins the strategy formulation process and environment. Bourgeois synthesized the two concepts, strategy and environment by relating them at their hierarchical levels. Bourgeois defined strategy as ‘determining how an organization defines its relationship to its environment in the pursuit of its objectives’. Strategy is further divided into domain definition strategy and domain navigation strategy.

Domain definition strategy refers to the organization’s choice of domain or change of domain that occurs when, for example, a firm diversifies into or exits from particular products or markets. Domain navigation strategy refers to competitive decisions made within a particular product-market or task environment. Since domain selection and navigation occur more or less sequentially (Gilmore, 1971) Bourgeois (1980) refers to them as primary and secondary strategies. Further, Bourgeois relied on the four environmental components outlined by Dill (1958), customers, suppliers, competitors and regulator groups and the fifth one, technology, added to by Duncan (1972) to demonstrate that one can use objective indicators of the environment and still be able to consider management’s perceptions of these components. Therefore, Bourgeois concluded that perceptions about environmental factors are relevant to domain navigation decisions made by strategy makers.

Based on the above argument, my conceptual framework identifies the primary strategy pursued by each of the three providers as entry into the F&A markets to gain a foothold in a market which is positioned towards significant growth. Next, each provider’s secondary strategy includes identifying distinctive competencies to negotiate with the environment based on the management’s perception of the environment. The four environmental factors

that were identified at the outset of this study, comprising the task environment for the three service providers in the F&A markets, were emphasis on corporate governance (regulator), emphasis on compliance (regulator), increased competition (competitor) and risk management (technology). Each provider, then developed secondary strategies (distinct competencies) based on the top management's perception of their task environment. These sequential relationships are depicted in Figure 1. The four factors comprising each provider's task environment are listed in the order of importance attributed to them by each provider's senior management. The task environment as perceived by the provider's managers thus dictates the secondary strategy adopted by each provider to develop distinct competencies and sustain their competitive advantage.

Summary and Conclusion

The FAO market is grossly under-penetrated across all regions and verticals, and there is still substantial opportunity for growth provided the service providers take into account the costs and risks that are faced by their clients and are able to deliver valued services. The advent of FAO is indicative of a recent development which may permanently alter the manner in which financial reporting is performed in the US. In this study, I develop a conceptual framework that examines the factors that enable service providers to maintain market share by recognizing the issues that endanger the survival of FAO and developing competencies to address these issues. The primary source of data employed in this study to facilitate theory-building were semi-structured interviews with managers of three leading FAO service providers. Within-case analysis was conducted for each case study in order to become intimately familiar with the case as a stand-alone

entity followed by a cross-case analysis across all the three case studies. The analysis of the transcripts brought forth three important observations: top management executives of all three providers considered the four industry level drivers identified by me as important industry characteristics, their perception of the degree of importance that should be given to each of these four characteristics differed, the strategies pursued by each provider to develop distinct competencies in order to gain a competitive advantage varied with the exception of one or two factors that were common within the providers.

In this study, I develop a conceptual framework based on the concept of integration of strategy and environment (Bourgeois, 1980) along with Dill's (1958) definition of the components of top management's task environment since these studies suggested similar conceptual insights. The findings of my study suggest that the task environment as perceived by the provider's managers thus dictates the secondary strategy adopted by each provider to develop distinct competencies and sustain their competitive advantage. As Bourgeois (1980) suggests, the development of strategies to guide organizational activities is a key managerial function, and that guidance is accomplished through the effective co-alignment of organizational resources with environmental conditions. My study attempts to achieve a theoretical understanding of the process by maintaining that primary strategy (domain selection) is concerned with decisions about opportunities in the general environment, while secondary strategy (a competitive approach) involves navigating within a task environment. Further, environmental perception is an element distinct from the objective task environment and is a prime input to secondary strategy making. Exploring relationships between strategy and environment is very timely, given the competitive conditions faced by firms of all sizes in today's economy. My goal has

been to build on prior theory and research in order to provide additional insight into the competitive advantage construct in the relatively new FAO markets that have received little prior attention in research.

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**APPENDIX A: ETHICS RULINGS NO. 112, 12 AND 1 UNDER RULE 102, 201, 301
RESPECTIVELY.**

<p>ET Section 102 - Integrity and Objectivity</p> <p>ET Section 191: Ethics Rulings on Independence, Integrity, and Objectivity</p> <p>112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services</p>	<p>112.225</p> <p><i>Answer</i>—Yes. The concept of integrity set forth in Rule 102, Integrity and Objectivity [ET section 102.01] and Article III, Integrity [ET section 54] requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member from his or her obligations under Ethics Ruling No. 1 [ET section 391.001-.002] under Rule 301, Confidential Client Information [ET section 301.01]. If the client objects to the member’s use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.</p> <p>A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services (for example, record storage, software application hosting, or authorized e-file tax transmittal services) to the member.</p> <p>See Ethics Ruling No. 12 under Rule 201, General Standards, and Rule 202, Compliance With Standards [ET section 291.023-.024]; and Ethics Ruling No. 1 under Rule 301, Confidential Client Information [ET section 391.001-.002], for additional responsibilities of the member when using a third-party service provider.</p>
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<p>Rule 201—General Standards Rule 202—Compliance with Standards</p> <p>291 - Ethics Rulings on General and Technical Standards</p> <p>12. Applicability of General and Technical Standards When Using a Third-Party Service Provider</p>	<p>.024</p> <p><i>Answer</i>—Using a third-party service provider to assist the member in providing professional services to clients does not in any way relieve the member from his or her responsibilities to comply with the requirements of Rules 201 and 202. Accordingly, the member remains responsible for the adequate oversight of all services performed by the third-party service provider and for ensuring that all professional services are performed with professional competence and due professional care. In addition, the member must adequately plan and supervise the professional services provided by the third-party service provider, obtain sufficient relevant data to support his or her work product and comply with all technical standards applicable to the professional services.</p> <p>This ruling does not extend the member's responsibility for planning and supervising the work of a third-party service provider beyond the requirements of applicable professional standards, which may vary depending upon the nature of the member's engagement. See Ethics Ruling No. 112 under Rule 102, Integrity and Objectivity [ET section 191.224-.225], and Ethics Ruling No. 1 under Rule 301, Confidential Client Information [ET section 391.001-.002], for additional responsibilities of the member when using a third-party service provider.</p>
<p>301 - Confidential Client Information</p> <p>391 - Ethics Rulings on Responsibilities to Clients</p> <p>1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member</p>	<p>.002</p> <p><i>Answer</i>—No. Rule 301 is not intended to prohibit a member in public practice from disclosing confidential client information to a third-party service provider used by the member for purposes of providing professional services to clients or for administrative support purposes. However, before using such a service provider, the member should enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and be reasonably assured that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the third-party service provider's controls and procedures to safeguard confidential client information.</p>

APPENDIX B: PROPOSED AMENDMENT TO IRS DISCLOSURE SECTION 7216

Guidance Necessary To Facilitate Electronic Tax Administration-Updating of Section 7216 Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

Sec. 301.7216-3 Disclosure or use permitted only with the taxpayer's consent:

(a) In general--(1) Taxpayer consent. Unless section 7216 or Sec. 301.7216-2 specifically authorizes the disclosure or use of tax return information, a tax return preparer may not disclose or use a taxpayer's tax return information prior to obtaining consent from the taxpayer, as described in this section. The consent must be knowing and voluntary. As an example, a tax return preparer may not condition its provision of preparation services upon the taxpayer's consenting to a use of the taxpayer's tax return information. Except as provided in paragraph (a) (2) of this section, conditioning the provision of services on the taxpayer's furnishing consent will make the consent involuntary, and the consent will not satisfy the requirements of this section.

(2) Taxpayer consent to tax return preparer furnishing tax return information to another tax return preparer. A tax return preparer may condition its provision of preparation services upon a taxpayer's consenting to disclosure of the taxpayer's tax return information to another tax return preparer for the purpose of performing services that assist in the preparation of, or provide auxiliary services in connection with the preparation of, the tax return of the taxpayer.

Source: www.irs.gov

APPENDIX C: INTERVIEW QUESTIONS FOR MANAGERS OF LEADING SERVICE PROVIDERS IN THE FINANCE AND ACCOUNTING OUTSOURCING INDUSTRY IN INDIA

General Strategy Questions	1. Can you identify and describe the primary factors that, in your opinion, contribute to maintaining your company's competitive advantage as compared to other firms in the field of FAO?
	2. What is the position of your company in the Industry and what percentage of the market share is controlled by your company?
	3. Can you rate the following factors individually, on a scale of 1-3, with 1 being very important, 2 being somewhat important, and 3 being not important, as factors that are essential to maintain your company's competitive advantage in the field of FAO? i. Emphasis on Client's Corporate Governance ii. Emphasis on Compliance iii. Client Risk Adversity iv. Increased Competition
	4. Increased regulatory requirements faced by the clients should translate into procedures specifically designed to ensure effective governance and compliance. Is there a well documented plan to understand and address every individual client's corporate governance mechanisms?
	5. Have you invested in a stated governance structure and framework to monitor and manage ongoing FAO engagements? If so, can you please describe the same?
	6. Are there formal systems in place to help the client prevent and detect the occurrence of fraud, errors or other irregularities in the financial statements?
	7. Are there any conscious attempts to take steps to improve the quality of client's financial reporting?
	8. Most FAO contracts are drawn for duration of 3-5 years. What steps do you take to build an effective long term relationship with the client? 9. Is there a conscious attempt to build the client's trust? What measures, if any, are taken to gain a trusted advisor status?

Emphasis on Compliance	10. Do you have procedures in place to deal with the client's fear that outsourcing will lead to failures of compliance with regulatory requirements?
	11. What are the SOX compliance measures that are in place?
	12. Do you conduct periodic compliance reviews?
	13. Are there clear lines of accountability?
	14. What is the procedure for establishing Service level agreements (SLAs) that support defined processes and key compliance requirements?
	<p>15. In order to provide services relating to Sarbanes-Oxley, does the company have the following core competencies? Please check as many boxes as apply. Also, please elaborate on how each competency that is applicable to your company is being addressed.</p> <ul style="list-style-type: none"> ○ Expertise in company processes, especially financial management. ○ Accounting skills, including having CPAs on staff. ○ A database that knows what the key corporate internal controls are. ○ Deep comprehension of the Act itself. ○ Supporting technology to store the processes, identify and document risks, and query those accountable.
	<p>16. Does your company have one or more of the following SOX related procedures in place?</p> <ul style="list-style-type: none"> ○ Facilitate compliance with record-retention rules. ○ Assist in meeting requirements relating to mandatory Web access of corporate filings. ○ Help to comply with rules requiring insiders to electronically report stock trades. ○ Develop codes of business ethics. ○ Help to comply with financial reporting requirements and deadlines. ○ Offer fraud examinations, forensic and security auditing, and vulnerability analyses. ○ Rate and rank corporations' governance practices. ○ Provide whistleblower reporting systems.

Client Risk Adversity	17. How does your firm specifically deal with issues such as risk mitigation, business continuity, privacy, and information security?
	18. What are the specific risk reduction strategies that are in place to mitigate client's risks associated with outsourcing F&A?
	19. How are specific risks identified? Are controls established on a process by process basis and are these controls maintained to the level specified by the client?
	20. What about security risks?
	21. Are there clear objective metrics and deliverables?
	22. How do you address client's worry about loss of control associated with FAO?
Increased Competition	23. Who are your primary competitors?
	24. Do you face competition from the buyer organizations themselves whether they own/operate captive centers offshore, or have shared service centers? How do you cope with these competitors?
	25. Do escalating costs of bidding place barriers on capturing new FAO clients?
	26. How are you coping with competition from other low-cost countries?

Behavioral Characteristics of ‘contractual man’

Bounded Rationality

Opportunism

Reciprocity	Identity matters	Deception
Normative expectations of contractual schemes	Veiling the identity of the TPSP	Concealing Privately held information
	Effectiveness	Defection
	Defeasance	
	Failure to procure specific client consent	

Figure C.1. Contracting problems and Disclosure

Note: Contracting problems identified by Oosterhout et al. are presented in the cells’ northwestern corner and contracting problems identified as existing in the AICPA member-client relationship are presented in their southwestern corner in bold font.

Source: Adapted from Oosterhout et al. (2006)

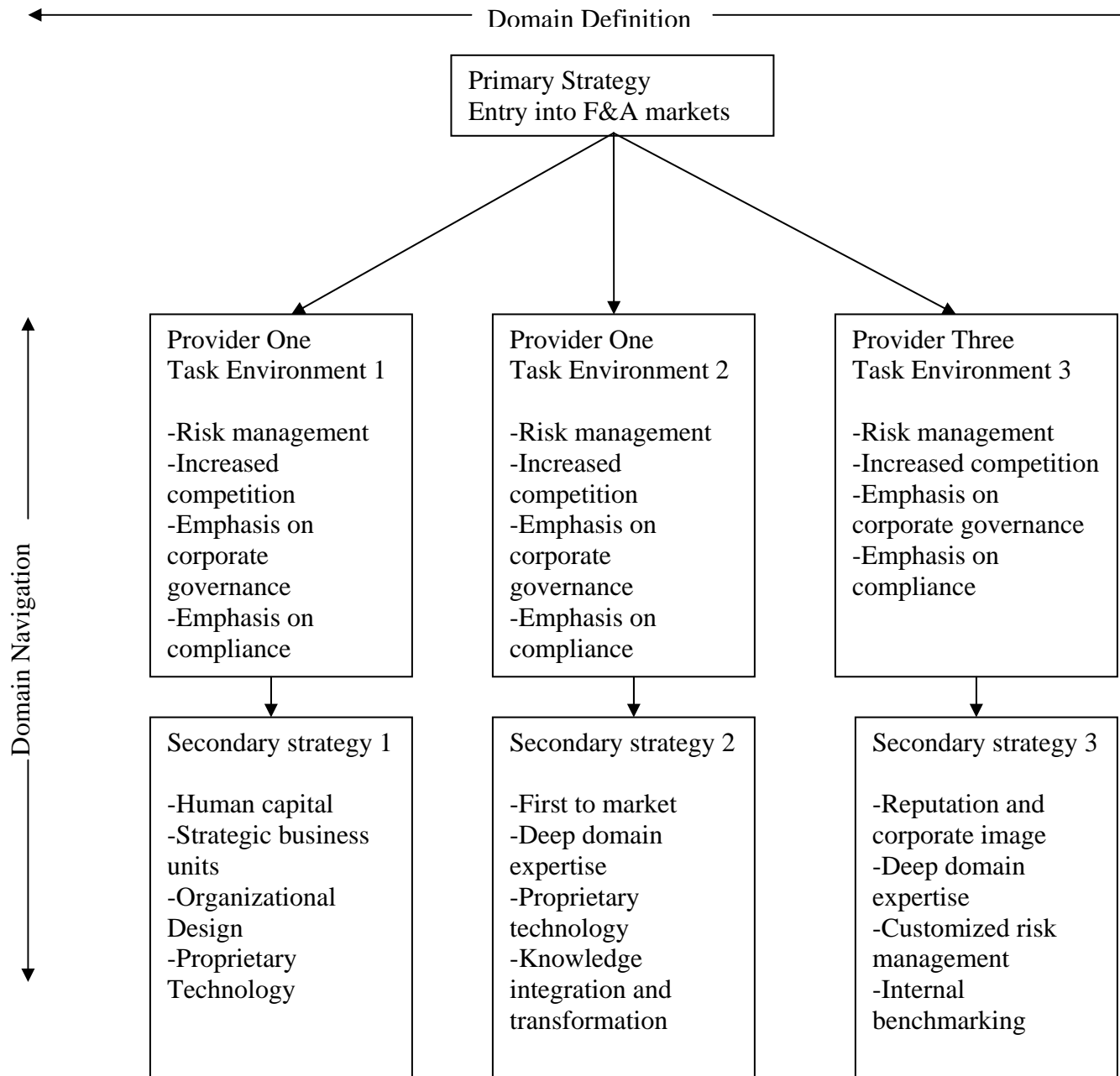


Figure C. 2 Domain Model

ⁱ Facilitators provide the website and access to Chartered Accountants (CAs) needed for offshore outsourcing. Four prominent facilitators are the Commerce Clearing House (CCH), Outsource Partners International (OPI), SurePrep and Xpitax. The basic process of tax outsourcing requires six steps which are described below. The CPA gathers the client's tax information and scans it into electronic files. Next, the CPA uploads these files to the facilitator's website. The facilitator encrypts the files and makes them available to the CA partner (or partners) in India. CAs in India prepare and review the return, and, post the returns, work papers, notes, and reconciliations to the facilitator's website. The CPA downloads the completed return and documents from the facilitator's website. The CPA reviews and signs the return, and, forwards it to the client for filing. (Robertson et al. 2004). Examples of services that may be outsourced include tax preparation and processing, bookkeeping, certain audit procedures performed by contract staff, outside specialist services in connection with an audit, human resources services, investment advisory services, workpaper storage or destruction services (Miller and Anderson, 2004).

ⁱⁱ Ethics Interpretations and Rulings promulgated by the AICPA do not have the force of law. At most, they are binding only on AICPA members, and even then an AICPA member is free to disregard ethics interpretations and rulings, provided they can carry the burden of justifying their departure in a disciplinary hearing. However, they do provide some guidance for ethical conduct and many accountants, whether AICPA members or not, are often hesitant to blatantly disregard such AICPA pronouncements.