Perceptions of U.S. CPAs and CMAs Concerning Accounting Standards, Regulation, and Ethical Financial Reporting

*Mary Jane Lenard**
*Pervaiz Alam***
*Norman Meonske***
*Michael A. Pearson***

Abstract

Ever since the scandals of Enron and WorldCom, accountants, legislators and investors have struggled with questions of how best to regulate the accounting profession and the implications of unethical financial reporting. This study surveys practicing accountants to determine their perceptions of the role of the SEC, FASB, and the U.S. Congress regarding the regulation of the accounting profession.

Our results show that IMA members who responded to the survey are concerned about earnings manipulation and the duties of auditors, including whether audit firms should be allowed to provide outside consulting services. The extent of earnings manipulation is influenced by the ethical values of the managers.

According to our study, the IMA members believe that the SEC should take a more active role in standard-setting when there is earnings manipulation influenced by ethical irresponsibility and when FASB's standards are not adequate or timely. They also believe that the independence of the audit firm should be stressed in standard-setting by FASB, and they believe that Congress should only get involved if external auditors are not independent and are the only ones who bear responsibility for the financial statements.

Finally, there are differences of opinion between CPAs and CMAs in the survey. Among these differences, CPAs believe more strongly that corporate management needs to accept more responsibility for the financial statements. The difference in responses due to differences in certification and job responsibility provides another area for investigation in efforts to improve the profession.

Keywords

CPA vs. CMA Perceptions
Accounting Standards
Corporate Governance
Ethical Financial Reporting

Introduction

The Enron, WorldCom, and other accounting debacles have raised serious questions about the integrity of financial reporting. As such, individuals and various organizations may be less willing to invest in stocks and bonds of large public companies because of a belief that accounting numbers disseminated by these entities can no longer be trusted.

A related question is whether the accounting firms that audit these companies can be trusted. U.S. lawmakers passed the Sarbanes-Oxley Act in 2002 to prevent fraudulent financial reporting.

The larger questions remain unanswered of how best to regulate the accounting profession: Should the self-regulatory model be used or will the accounting profession function more effectively if there is continuous congressional oversight?

This study surveys practicing accountants, to determine their perceptions of the role of the Securities and Exchange Commission (SEC), Financial Accounting Standards Board (FASB), and the U.S. Congress regarding the regulation of the accounting profession. The purpose of this study is to examine the respondents' perceptions of the best way to regulate the accounting profession. At the 28th Annual Professional

* Meredith College
** Kent State University

المنارة للاستشارات
www.manaraa.com

Development Conference sponsored by the Ohio Council of the *Institute of Management Accountants* (IMA), attendees were asked for their views of the appropriate role of various financial reporting participants. A previous paper presented the summary results of their responses (Alam, et al., 2003). This paper takes that study further in order to address whether a particular set of concepts influenced the opinions.

We present the background and theory for the development of the questionnaire, followed by the presentation of our research method and results, and a discussion of the contributions and limitations of our study.

Our results show that IMA members who responded to the survey are clearly concerned about the impact of accounting scandals on our society and the accounting profession. They express concern about earnings manipulation and the ethical responsibility of auditors, including whether audit firms should be providing consulting services. The respondents believe that the SEC should take a more active role in standard setting when there is earnings manipulation and when FASB's standards are not adequate or timely. They also believe that the SEC should take an active role along with management and external auditors in defining the responsibility for preparation of financial statements, and that the independence of the audit firm is essential. Finally, they believe that the U.S. Congress should get involved only when external auditors fail to bear their audit responsibilities.

Background

In order to analyse the opinions of survey participants, it is important to identify a set of concepts by which we frame the models, or contracts, that accountants use for managing their work. Sunder (2002) proposed a theory of organizational behaviour based on the contract model of organizations. These contracts can be self-regulated or they are likely to be enforced by regulatory bodies, such as the SEC or the U.S. Congress. Historically, regulations imposed by Congress conflict with the guidelines provided by the SEC for accounting rule making. For example, oil and gas companies are required to book reserves of oil and gas that the company expects to extract commercially. However, Shell Oil recently decided not to book 220 million barrels of oil equivalent for 2003 because the Congressional directive was out of line with the SEC guidelines (Cummins, 2004). This action affected the accounting records and reduced the company's reserve-replacement ratio to 82% from 98%. The reserve bookings have been a component for executive-performance reviews and for calculating bonuses, leading investigators to believe that the company may have been trying to manipulate earnings.

Another area of conflict is accounting for stock options. A new FASB requirement calls for companies to treat stock options as an expense. Without this treatment, it would be possible for companies to artificially inflate profits. The SEC is supportive of the FASB'S stance but postponed the required implementation date. In the meantime there is a movement in Congress to derail required expensing of stock options (Ranii, 2004). Representatives from companies, many of them high-tech firms, have lobbied Congress, the White House, and the SEC, arguing against the required expensing.

The individuals responding to the questionnaire in this study are those who are now subject to new regulation imposed by the government. These are the managers and CFO's who, under the Sarbanes-Oxley Act, must certify the effectiveness of internal controls involved in presenting the financial statements. As such, it is increasingly important to understand the opinions of these management accountants who are often subject to accounting regulation, but usually are least affected by direct government regulation. Since the process of self-regulation is affected by

المنارة للاستشارات
www.manaraa.com

professional standing, the contracts of accounting firms with third parties should be monitored by individuals who have the required expertise on the issues. This higher level of knowledge can be represented by professionals who have a certification as opposed to those who do not.

There may be a difference in how professionally certified individuals view their responsibilities. Thus, the responses of certified public accountants (CPAs) may be different from the responses of certified management accountants (CMAs). CPAs generally answer to a larger external constituency of users of financial statements whereas CMAs are typically responsible to the management of their employed firms. In addition, there are educational differences in the certification process, which may affect responses from the two groups. The accounting contracts that these professionals manage can be grouped into several areas, based on who should write or issue standards and who should implement them, and the professional and ethical issues involved in the implementation and reporting process.

We develop our research questions and variables based on the areas of interest described above as we investigate whether consideration of questions in these areas influences respondents' opinions about the regulation of the accounting profession. These are areas where members of the profession can make a difference in the ethical compilation, interpretation and reporting of financial information.

Accounting Standards

The development of accounting standards started with the Statements of Financial Accounting Concepts. These six concept statements were issued during the time frame of 1978-1985. The statements address issues such as the objectives and elements of financial reporting for business enterprises and non-business organizations, along with qualitative characteristics of business information, and recognitions and measurements in financial statements (Kieso, et al., 2003).

Currently, FASB and the SEC set accounting standards. Auditing standards have been set by the AICPA, but with the passage of the Sarbanes-Oxley Act of 2002, standards for audits of publicly owned companies are written by the Public Companies Accounting Oversight Board (PCAOB).

The AICPA's ten generally accepted auditing standards, set in 1947, are intended to aid auditors in fulfilling their professional responsibilities in the audit of financial statements (Arens, et al., 2005). The standards are organized into general standards, standards of fieldwork, and standards of reporting. Following the ten generally accepted auditing standards, statements on auditing standards (SASs) began being issued starting in 1972. The SASs are interpretations of the ten auditing standards.

The generally accepted accounting principles and generally accepted auditing standards reflect the *minimum* standards of performance (Arens, et al., 2005). As a result, the question before the profession is why this battery of accounting and auditing standards did not prevent fraudulent financial reporting in the recent scandals. Since it appears that the accounting profession's self-regulatory framework failed, the questions remain whether the new accounting board formed by the Sarbanes-Oxley Act (the PCAOB) should be the only body formulating accounting and auditing standards and what ethical issues need to be addressed. Currently, the PCAOB has begun formulating new auditing standards, while it has left the private sector to formulate accounting rules through FASB.

Financial Statement Responsibility and Reporting

Accountants must address where the responsibility for the financial statements lies. Since Congress passed the Sarbanes-Oxley Act, there are executive certification requirements, accelerated filing deadlines, and increased penalties for misconduct (Messmer, 2003). Specifically, Section 302 of Sarbanes-Oxley requires that CEO's and

المنارة للاستشارات
www.manaraa.com

CFO's of public companies certify that they have reviewed the quarterly and annual reports and that these reports do not contain materially false statements. Messmer (2003) has suggested various responses to the Sarbanes-Oxley Act. He indicates responses that accountants in organizations might consider, such as balancing time between strategic planning and traditional accounting duties, and whether they have evaluated all business risks and their potential impact. He also recommends that accountants consider whether their actions reflect and reinforce company values. Other authors have expressed the view of added responsibility from the standpoint of the internal auditor (Mullan, 2003) and management (Thomas and Gibson, 2003). Thomas and Gibson (2003) noted that Statement of Auditing Standards (SAS) No. 99 addresses management antifraud programs and controls. These articles raise questions about who should bear primary responsibility for ensuring the reliability of financial statements and what the content of these statements are meant to reflect.

Audit Committees and the Role of Outside Directors

Section 301 of the Sarbanes-Oxley Act requires the Board of Directors of public companies to hire and fire external auditors and that the audit committees be composed entirely of independent directors. Fields and Keys (2003) examine the role that outside directors and board diversity play in corporate governance and the role of the board of directors in influencing earnings management and managers' incentives to bear risk. Some studies found that outside directors have incentives to ensure that shareholder value is maximized because of concerns about their own reputation (Fama and Jensen, 1983; Gilson, 1990). Other studies show that outside directors provide beneficial monitoring and advisory functions to shareholders (Brickley and James, 1987; Hermalin and Weisbach, 1988; Weisbach 1988; Byrd and Hickman, 1992; Brinkley, et al., 1994). Hermalin and Weisbach (1998) also found that the members of the board of directors are affected by the CEO's performance, with outside directors often added to the board after poor firm performance.

When it comes to auditor-management disagreements, DeZoort, et al., (2003) found that audit committee members provide greater support for the auditor when the materiality justification included both quantitative and consequences-oriented factors. The audit committee composition and compensation can also be related to earnings management. For instance, Klein (2002) found that companies with independent boards and independent audit committees were much less likely to report abnormal accruals. In terms of compensation for services, Mong (2003) makes the case that it is time for change in audit committee remuneration. He noted that while the existence of the audit committee may improve governance structure, independence is widely recognized as a necessary key factor to ensure effective committee performance.

Mong (2003) wondered if certain forms of compensation allow for true independence. He found evidence that 99 percent of the top 200 companies pay their directors with shares of stock. When this happens, Archambeault and DeZoort (2001) found that committee share-owning members were more likely to switch auditors and opinion-shop. Deli and Gillan (2000) found that audit committees were less active when there were members with share ownership. Abdel-khalik (2002) has suggested that in a post-Enron world, companies should investigate the possibility of having shareholders' board of trustees, who are elected by the shareholders. The research question is whether ethical failures in reported earnings would be minimized with an independent and more vigilant board.

External Auditors, Internal Auditors and the Financial Statements

Wiedman (2002) noted that auditors have power because efforts by regulators and auditors to maintain high audit quality, emphasize auditor independence, and strengthen corporate governance will have a positive impact on the quality of financial reporting. In addition to the role of external

المنارة للاستشارات
www.manaraa.com

auditors, internal auditors have responsibilities as well. Eighme and Cashell (2002) identified responsibilities of internal auditors in reducing inappropriate earnings management. Internal auditors must assist management and the audit committee in the assessment of management risks, and they need to evaluate the effectiveness of relevant internal controls as well as risk management processes (Eighme and Cashell, 2002). Therefore, any regulation should address the perceived responsibilities of external and internal auditors, and the relationship between them on matters pertaining to internal controls. Section 404 of the Sarbanes-Oxley Act requires that annual reports contain an Internal Control Report describing the company management's assessment of internal control effectiveness. Further, the external auditors must audit that assessment in addition to auditing the company's financial statements.

Auditors as Consultants

Internal or external auditors can serve as consultants. McCall (2002) indicated that internal auditors currently find themselves performing a much broader spectrum of activities then ever before. And nearly three-quarters of fees paid to auditing firms are for non-audit work (Investor Business Relations, 2001). However, Weil and Tanenbaum (2001) reported that while companies with difficulties paid more, the performance of the companies often was improved with consulting work. While audit firms will still be able to provide consulting services under the Sarbanes-Oxley Act, they will not be able to provide certain consulting services to the companies they are auditing. Section 201 of the Sarbanes-Oxley Act disallows various types of non-audit services. Specifically, these services are: bookkeeping, financial information design and implementation, valuation, actuarial services, internal audit, human resources management and investment banking. Thus, to some extent the Sarbanes-Oxley Act minimizes the ethical conflict arising from providing auditing and consulting services to the same client.

Financial Reporting and Ethical Responsibility

To what extent is there manipulation of earnings in a company's financial statements? When does earnings management become earnings manipulation? Phillips, et al., (2003) studied earnings management involving deferred tax expense. They found that when managers had greater discretion under generally accepted accounting principles (GAAP), they exploited such discretion to manage income upward. This type of earnings management generated book-tax differences that increased deferred tax expense. In another approach, Abarbanell and Lehavy (2003) tried to predict earnings management based on stock recommendations. Their results showed that firms rated as a sell (buy) engaged more (less) frequently in extreme, income-decreasing earnings management. In addition, if firms were rated as a sell (buy), they were less (more) likely to engage in earnings management that left earnings equal to or higher than analysts' forecasts.

In a survey of aggressive accounting practices, Scott (2002) found that the 253 audit partners and managers participating had collectively come across 2,630 earnings management attempts. Section 204 of the Sarbanes-Oxley Act requires the CEO's and CFO's of domestic and foreign public companies to reimburse any incentive pay or trading profits received in the twelve-month period following the issuance of financial statements that are later restated as a result of fraudulent financial reporting.

This discussion prompts questions about the conditions that might tempt a company to manipulate earnings, as earnings management in the extreme becomes earnings manipulation. This is when an ethical component comes into play. What is the influence of analysts' expectations in managing earnings? And since management compensation often includes stock payments or may be tied to stock performance, does the type of compensation lead to earnings manipulation and poor ethical performance? Section 406 of the

المنارة للاستشارات
www.manaraa.com

Sarbanes-Oxley Act addresses the incidence of earnings management by requiring public companies to file with the SEC whether they have adopted a code of ethics for senior financial officers. As a minimum, the code should prescribe actions on matters of conflict of interest, financial reporting, and compliance with governmental regulations.

Personal and Professional Characteristics of Auditors

Professional ethics of the individual may reflect his or her moral character, but how do we know if the individual will try to "beat the system" and not adhere to the standards? The theory of planned behaviour contains the constructs of attitude, subjective norms, and perceived behavioural control. These constructs can be used to determine an individual's compliance with appropriate accounting rules (Bobek and Hatfield 2003). Thus, an individual's ethical background may influence the degree to which he or she feels that companies and auditors can monitor themselves, without the influence of the government or SEC. The strength of those ethical values may depend on the person's position in the company, his or her level of experience, the type and scope of the industry in which the person works, and the particular certification that the person has completed. In order to protect the public interest, Section 103 of the Sarbanes-Oxley Act requires the PCAOB to establish ethical standards for the guidance of practicing accountants and auditors.

Professional Education and Certification

Professional certification requires a combination of testing and adoption of an "ethical contract." An overview of the web site offered by Gleim, offering review materials for the various exams (Gleim 2005), reveals details of the exam offerings. For the CPA exam, there are currently four parts to the exam: *Auditing and Attestation*, which includes an evaluation of internal control, topics on information systems auditing, and rules of evidence; *Business Environment & Concepts*, which includes topics on economic concepts, cost accounting, and general information technology; *Financial Accounting & Reporting*, which includes all topics from the Intermediate Accounting course, plus non-profit concepts; and *Regulation*, which contains a section each on ethics, law, and taxation.

On the other hand, the CMA exam includes sections on: *Business Analysis*, including topics on microeconomics and macroeconomics, as well as internal audit, linear programming, and financial statement analysis; *Management Accounting and Reporting*, including topics on cost accounting, budgeting, information systems, and SEC requirements; *Strategic Management*, including manufacturing paradigms, finance, decision analysis, cost-volume-profit analysis, and capital budgeting; and *Business Applications*, which is a section composed entirely of essays from the first three parts, in addition to organizational theory, motivation and directing, behavioural issues, and ethics. So the CMA exam appears to differ from the CPA exam in its emphasis on decision making and management issues within the corporation.

In addition to these two exams, however, there are two other certifications worth mentioning. First is the Certified Internal Auditor (CIA) exam. This exam also has four sections. They are composed of: *Internal Audit Role*, which includes topics on roles, responsibilities, standards, control, and managing internal audit; *Engagement,* which covers preparation of working papers, communication, statistics, ethics, and fraud; *Business Analysis and Information Technology*, including financial accounting and legal issues; and *Business Management*, which covers topics of global issues, managing groups, and conflict and negotiation.

The second certification of note is the Certified Fraud Examiner (CFE) exam. This exam is issued by a separate entity, the Association of Certified Fraud Examiners, which maintains a separate web site (Association of Certified Fraud Examiners, 2005). This exam is not even based entirely on accounting topics, and as such it can be taken by anyone with a Business degree. It

المنارة للاستشارات
www.manaraa.com

includes the following sections: *Criminology and Ethics*, which includes topics on the administration of criminal justice, theories of crime causation, theories of fraud prevention, and ethical situations; *Financial Transactions*, which covers internal controls and types of fraudulent financial transactions; *Fraud Investigation*, which covers interviewing, evaluating deception, obtaining information from public records, and report writing; and *Legal Elements of Fraud*, which includes criminal and civil law, rules of evidence, rights of the accused and accuser, and treatment of expert witnesses. If anything, this exam covers more relevant topics of fraud prevention and detection than the accounting certification exams. Recent changes in Accounting curriculums include courses in fraud examination (Crumbley and Apostolou, 2002; Buckhoff and Schrader, 2000), and at least one article hints that the forensic approach should always have been applied (Peloubet, 1946). In fact, many of these courses are offered to all business students, not just accounting majors.

Research Method

Development of the Questionnaire

For the purposes of this study, a questionnaire was designed to elicit individual perceptions on various financial reporting issues, along with opinions on who should implement the regulations that form the contract for control in organizations (see Appendix 1). At the 28th annual Professional Development Conference sponsored by the Ohio Council of IMA, attendees were asked for their views of the appropriate roles of various financial reporting participants. One hundred seventy-three of the 400-plus IMA members present responded to the survey statements describing possible responsibilities, actions, and functions of reporting companies, external auditors, and others involved in the financial reporting process. This resulted in a response rate of approximately 43 percent. A Likert five-point scale was used in developing the questionnaire: strongly agree, agree, neutral, disagree, and strongly disagree.

Factor Analysis

Exploratory factor analysis was used to identify and operationalise the key variables to be used in the study. We performed principal axis analysis with varimax rotation. This method spreads the variance evenly among factors and is appropriate for exploring the underlying dimensions of a construct. The method is based on the conservative method of estimating communality by using the squared multiple correlation in the diagonal of the correlation matrix. Factor analysis is appropriate if there is sufficient correlation among most of the variables (Bartlett, 1950). Prior to the analysis, two factoring criteria were established: (1) to define a factor as having at least two items with loadings of 0.50 or greater, and (2) to select the minimum number of independent factors which explain as much of the common variance as possible in the final solution. From our questionnaire, we determined that questions 17, 18, and 19 reflected the questions about the dependent variable that we were trying to measure (See Appendix for the list of questions). These questions seek to determine, in the opinions of the accountants completing the survey, which group(s) should be involved in setting accounting standards.

Table One lists the seven factors and the items with loadings of 0.50 or greater that were produced from our analysis. These seven factors explain 53% of the variance and are labelled as ETHREP, EMPLOY, FINRES, OUTSER, AUDCOM, ESTSTD, and PROFRESP.

The first factor (ETHREP) includes the questions on whether compensation plans or analysts' expectations may influence managers to manipulate accounting numbers (questions 3 and 4). This factor measures whether managers will engage in ethical behaviour in financial reporting.

www.manaraa.com

Table One: Principal Component Analysis and Rotated Factor Loadings

Factor	Factor Loading	Eigenvalue	%	Cum. %	Alpha
1 – Earning Management (ETHREP)					
Q3 - Compensation plans cause managers to manipulate earnings	0.797	2.46	10.709	10.709	.6765
Q4 – Analysts' expectations affect earnings management	0.778				
2 – Type of employment (EMPLOY)					
Q23 - Industry of respondent's employment	0.814	2.13	9.275	19.983	.6890
Q24 - Whether the respondent is employed with regional, national, or multinational firm	0.792				
3 – Financial statement responsibility (FINRES)					
Q1 - Management of a firm is primarily responsible for financial statements	0.914	1.94	8.452	28.435	.8816
Q2 - Financial statements do not report important economic information about the firm	0.912				
4 – Consulting services (OUTSER)					
Q12 - Firms providing external audit service should not provide consulting services to anyone	0.755	1.63	7.072	35.507	.6119
Q13 - Rotation of auditors every 5 years is a good idea	0.649				
Q11 - Accounting firms should not be permitted to provide external auditing and consulting services to the same client	0.639				
5 – Audit committee (AUDCOM)					
Q7 - The societal role of audit committees needs to be strengthened	0.679	1.53	6.639	42.146	.4491
Q8 - Audit committees should have the power to hire/fire auditors	0.643				
Q6 - Audit committee should consist solely of individuals independent of the firm's management	0.592				
6 – Established standards (ESTSTD)					
Q15 - FASB has failed to establish adequate accounting standards for new and emerging business transactions	0.832	1.34	5.805	47.951	.5606
Q16 - External pressure has resulted in less than timely establishment of accounting standards by FASB	0.676				
7 – Professional responsibility (PROFRESP)					
Q9 - A firm's external auditors should be primarily responsible for ensuring the reliability of client's financial statements	0.751	1.23	5.348	53.299	.3379
Q10 – Auditors should provide assurance that financial statements are free of material fraudulent misstatements	0.500				

Factors loadings greater than +_ 0.50 are used in defining a significant factor. Principal axis analysis with varimax rotation is used to extract factors. Standardized alpha for the model is 0.5207.

The second factor (EMPLOY) includes the questions about an individual's industry of employment and whether the respondent is employed with a regional, national, or multinational firm (questions 23 and 24). The third factor (FINRES) addresses the issue of financial reporting and responsibility, by including questions about whether management should bear primary responsibility (question 1) and whether important facts that accurately reflect economic conditions are reported in the financial statements (question 2). The fourth factor (OUTSER) includes the

المنارة للاستشارات
www.manaraa.com

questions about whether accounting firms should be permitted to provide both external auditing services and consulting services to the same client (question 11), whether audit firms should be permitted to provide any consulting services at all (question 12), and whether rotating audit firms every five years is a good idea (question 13).

Factor 5 (AUDCOM) includes the questions about the composition and role of a company's audit committee (questions 6, 7 and 8), Factor 6 (ESTSTD) addresses the questions about the FASB's possible failure in establishing adequate accounting standards for new and emerging business transactions and whether the external pressure on FASB has resulted in less than timely establishment of accounting standards (questions 15 and 16). We view this as an issue of independence in monitoring and establishing accounting standards. Finally, factor 7 (PROFRESP) addresses whether a firm's external auditors should bear primary responsibility for ensuring the reliability of the client's financial statements, and whether auditors should provide assurance that the financial statements are free of material misstatements (questions 9 and 10). Several regression models, described below, were developed using the scores of the seven factors as independent variables, in order to test the significance of those various factors to the members of the profession in assessing the dependent variable.

Logistic and Regression models

OLS Regression Model

Using the variable names defined above, the following regression model was developed to distinguish whether the SEC, the U.S. Congress, or a FASB-like board should regulate accounting and auditing standards:

$$Y = \alpha_0 + \alpha_1 ETHREP + \alpha_2 EMPLOY + \alpha_3 FINRES + \alpha_4 OUTSER + \alpha_5 AUDCOM + \alpha_6 ESTSTD + \alpha_7 PROFRESP + \delta \quad (1)$$

Where:
ETHREP represents earnings management, EMPLOY is the industry of employment of the respondents, FINRES is financial statement responsibility of management, OUTSER is outside services provided by accounting firms, AUDCOM is the role of audit committees in monitoring auditors, ESTSTD represents the timeliness of accounting standards, and PROFRESP is the auditor responsibility in ensuring reliability of financial statements. Equation (1) is run separately for each of the following groups: SEC, U.S. Congress, and a FASB-like board. Thus, the dependent variable, Y, represents the average responses to questions 17, 18, and 19.

Logistic Model

In order to address whether the CPAs and CMAs responded differently on the dimensions identified through factor analysis, a Logistic regression model was developed. The dependent variable (I) is coded 1 if the respondent is a CPA and coded 0 for a CMA respondent. Thus, the following Logistic regression model is developed using the factor scores of the seven factors identified previously as independent variables.

$$I = \alpha 0 + \alpha 1\ ETHREP + \alpha 2 EMPLOY + \alpha 3 FINRES + \alpha 4 OUTSER + \alpha 5 AUDCOM + \alpha 6 ESTSTD + \alpha 7 PROFRESP + \delta \quad (2)$$

Results

OLS Regression Estimates

The respondents were asked whether the SEC or the U.S. Congress should be formulating accounting standards and whether auditing standards should be established by an independent board using a process similar to the one used by the FASB. Presently accounting standards are written primarily in the private sector by the FASB. However, the SEC monitors the rule making process of the FASB and also writes accounting rules on controversial issues where FASB may not have the necessary influence to get popular support. Until the passage of the Sarbanes-Oxley Act of 2002 the Auditing Standards Board of the AICPA wrote auditing standards. In order to assess whether variables identified through factor analysis would be of use in distinguishing responses of CPAs versus CMAs, we perform OLS regression

المنارة للاستشارات
www.manaraa.com

analysis by using responses on questions 17, 18, and 19 pertaining to SEC, U.S. Congress, and FASB-like board, respectively. There are 160 complete responses that are available for this analysis.

Table Two, Panel A shows the results of the OLS regression. The mean score on the question of whether the SEC should take a more active role in the establishment of accounting standards is 3.19, which is a value that is close to a neutral response.

The first column of Table Two, Panel A shows the coefficients and t-values for those who responded that the SEC should take more active role in the establishment of accounting standards. The table shows that the ETHREP, OUTSER, ESTSTD, and PROFRESP variables are positively significant. These results suggest that the idea of the SEC taking a more active role in the establishment of accounting standards was significantly affected by the beliefs that: 1) compensation plans and analysts' expectations affect earnings management, 2) accounting firms should not provide consulting services and auditors should be rotated every 5 years[1], 3) FASB has not formulated timely standards for new and emerging businesses, and 4) the auditors are the primary group responsible for the reliability of financial statements.

The results on the question of the U.S. Congress formulating accounting standards reflect a mean response of 4.29 on question 18, which is overall disagreement. Significant factors determining the role of the U.S. Congress in formulating accounting standards are that: 1) accounting firms should not provide consulting services and auditors should be rotated every 5 years, and 2) the external auditors are the primary group responsible for the reliability of the financial statements. In other words, for the U.S. Congress to be involved, the respondents believe that accounting firms would have to display a lack of independence in the performance of their audit and assurance services.

Finally, in Table Two, Panel A shows that the respondents believe that auditing standards should be written by an independent board (question 19, mean = 2.43) similar in structure to the FASB. A mean score of 2.43 is closer to agreement on this issue by the respondents. The significant variable is AUDCOM. Thus, respondents believe that the audit committees should be independent of management, they should have the power to appoint/remove external auditors, and the role of the audit committees should be strengthened.

Logistic Estimates

A total of 160 respondents indicated that they were either CPAs or CMAs and they are all employed in industry. Of this number 129 hold CPA certification and 31 are CMAs. The dependent variable is coded 1 representing CPAs and 0 for CMAs. The results of the Logistic regression model are shown in Table Two, Panel B. The model correctly predicts 83.1% of the responses and it is significant as indicated by the log likelihood ratio. These results show that the EMPLOY variable is positively and significantly associated with the dependent variable suggesting that CPAs' industry of employment and the type of firm (regional, national, multinational) influence their response whereas that is not the case for CMAs. The significantly positive coefficient for the FINRES variable indicates that CPAs believe that the primary responsibility for financial reporting rests with the management of the firm and that the financial statements omit material facts about the firm. However, a similar opinion was not held by CMAs. CPAs agreed that firms should not provide both auditing and consulting services, as indicated by the significant OUTSER variable, while CMAs did not hold a similar opinion.

[1] Section 203 of the Sarbanes-Oxley Act of 2002 requires public accounting firms to rotate engagement and review partners every 5 years.

المنارة للاستشارات
www.manaraa.com

Table Two: OLS and Logistic Regression Estimates for the Role of the SEC, U.S. Congress and FASB in the Establishment of Accounting Standards

Panel A: OLS Regression Estimates

	SEC		**US Congress**		**FASB-like Board**	
Variable	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Constant	3.194	42.66***	4.288	68.26***	2.425	30.54**
ETHREP	0.179	2.38**	0.050	0.80	0.074	0.93
EMPLOY	0.092	1.22	0.078	1.25	0.046	0.59
FINRES	–0.117	–1.56	–0.085	–1.30	–0.029	–0.29
OUTSER	0.136	1.81*	0.249	3.94***	0.128	1.60
AUDCOM	0.001	0.01	0.047	0.74	0.163	2.05**
ESTSTD	0.209	2.78***	0.039	0.63	–0.022	–0.27
PROFRESP	0.299	3.98***	0.157	2.49**	0.099	1.25
Adjusted R- square	0.156		0.110		0.017	
F-value	5.205***		3.805***		1.383	
Number of observations	160		160		160	

Panel B: Logistic Regression Estimates
(Dependent variable: CPA = 1, CMA = 0)

Variable	Coefficient	t-value
Constant	2.151	6.504***
ETHREP	–0.141	–0.596
EMPLOY	1.174	3.743***
FINRES	0.679	2.031**
OUTSER	0.518	2.034**
AUDCOM	0.415	1.600*
ESTSTD	0.066	0.271
PROFRESP	0.869	3.015***
Percent correct prediction	83.1%	
–2 log likelihood	109.79	
Number of observations	173	

The dependent variable varies by which entity should play the more active role in standard setup – SEC, U.S. Congress, FASB. ***, **, *, significant at 1%, 5%, and 10% respectively, where ETHREP represents earnings management, EMPLOY is the industry of employment, FINRES is management's financial statement responsibility, OUTSER is the consulting services provided b an accounting firm, AUDCOM is the role of audit committees in monitoring auditors, ESTSTD represents the timeliness of accounting standards, and PROFRESP is the auditor responsibilities in ensuring the reliability of client's financial statements.

CPAs also agreed that the responsibility for assuring the *reliability* of financial statements rests with the firms' external auditors, even while believing that the primary *responsibility* for the statements rests with management, which was not how CMAs viewed this issue. This view is measured using the PROFRESP variable. Finally, there is also some disagreement between the CPAs and CMAs on the AUDCOM variable. This variable is found to be significant only at 10%. CPAs believe that the audit committees should be independent of management, that they should have the power to appoint/remove external auditors, and the role of the audit committees should be strengthened.

Finally, the ETHREP and ESTSTD variables are found to be insignificant in the Logistic regression. In other words, with respect to these variables the CPAs and CMAs held similar opinions.

These comparisons highlight the fact that CPAs would like management to accept more responsibility for the financial statements. They would also like the audit committees to be stronger. Further, the CPAs believe that accounting firms should improve their appearance of independence and not offer consulting services to anyone. We believe that the differential responses of the CPAs versus CMAs may be partly as a

المنارة للاستشارات
www.manaraa.com

result of the education and training of the practitioners.

Conclusions

The accounting profession has clearly lost stature because of Enron, WorldCom, and other recent accounting scandals. There is enough blame to go around. However, more important than pointing fingers is taking action that will result in accountants and auditors (and their work products) being viewed favourably once again. Thus, the profession needs to regain control and restore equilibrium through the "redesign, negotiation, and implementation of contracts" (Sunder 2002). This study contributes to the literature because our results provide the groundwork for a discussion of how the contracts of the accounting profession might be redesigned.

Reporting and Ethical Responsibility

According to our study, several significant factors influence members of the profession in their opinions about whether the SEC, the government, or an independent board should be involved in establishing accounting standards. First, the respondents believe strongly that the SEC should take a more active role in standard setting when there is earnings manipulation. The coverage of these topics by the Sarbanes-Oxley Act is two-fold, with one section covering behaviour of accountants, and other sections addressing company officers and employees: Section 103 allows the PCAOB to govern ethical standards of accountants and auditors, while Section 204 pertains to top executives, who must reimburse any incentive pay gained following the issuance of restated financial statements.

In addition, Section 406 of the Sarbanes-Oxley Act requires public companies to file with the SEC whether they have adopted a code of ethics. As a minimum, the code should prescribe actions on matters of conflict of interest, financial reporting, and compliance with governmental regulations.

Financial Statement Responsibility

The respondents in our study further believe that FASB has failed to provide adequate standards for new and emerging businesses, that external auditors should take responsibility for assuring the reliability of the financial statements, and that the independence of the audit firm should be maintained by not providing audit and consulting services. As the respondents are professional accountants, this indicates that they are willing to accept more responsibility for financial reporting. In other words, they believe we as accountants should "get our own house in order" and cooperate with the SEC in their role of enforcing regulations.

However, the Sarbanes-Oxley regulations are again addressed at company executives as well as accountants. Section 201 disallows the performance of certain non-audit services by auditors for the same client, while Section 302 requires CEO's and CFO's to review and sign a statement attesting to their responsibility for the annual and quarterly reports issued by the company. In addition, Section 404 requires top executives to attest to the reliability of the company's system of internal control.

Accounting Standards

The respondents are in agreement that the U.S. Congress should *not* take an active role in the establishment of accounting standards. With a continued emphasis on education and ethics in the accounting profession, it is clear that accountants continue to focus on independence and professional responsibility. According to our respondents, problems in these areas are the only factors that will justify the involvement of the U.S. Congress in accounting standard setting. Further, there is no actual standard-setting *process* defined by Sarbanes-Oxley that is equivalent to the participative process currently in use by the FASB.

المنارة للاستشارات
www.manaraa.com

The respondents in our study also believe that a weak audit committee is a significant factor in adversely affecting the role of the board of directors. Section 301 of the Sarbanes-Oxley Act does require that the Board of Directors be involved in the hiring of the external audit firm.

Professional Certification

Finally, the CPAs and the CMAs expressed some differences. Their responses differed by the type of industry and company they represented, the extent of financial statement reporting responsibility, their opinions about the outside services that auditors can perform, the role of the audit committee, and whether external auditors should have primary responsibility for assuring the reliability of the financial statements.

The CPAs see the need for management to accept more responsibility for their company's financial statements. So how can managers accept more responsibility? With the implementation of The Sarbanes-Oxley Act, management is already responsible for further disclosure of financial information. Yet accountants and auditors will still be responsible for analysing a company's financial statements for fraudulent information. Will better training, or a different educational background, help accountants recognize what that information should be?

Sarbanes-Oxley does not address issues of certification and education of auditors. The Act also does not have separate consideration for internal auditors or accountants who work for public companies. In a comparison of the various certification exams, the CMA and CIA exams cover more topics of management and analysis, motivation, directing and controlling, and roles and responsibilities than the CPA exam. These are areas of corporate governance that we believe are necessary for the successful implementation of Sarbanes-Oxley. Further, much of the focus of Sarbanes-Oxley – fraud detection and prevention – is on topics that are covered more specifically on the exam for certification in fraud examination (CFE), which is not strictly an accounting certification.

Future Research and Implications

Our paper has documented some differences in how members of the profession with different certifications view the issues involved in financial reporting. In addition, regardless of the type of certification an individual receives, the work responsibilities, or organizational contracts, of one individual may be different from those of another individual with the same certification. In that case, which contract is more important when an accountant is involved in the financial reporting process – the individual's contract based on their certification, or the individual's contract with the organization? How can our educational system or our certification process provide guidance, or priorities, when there are conflicts between these contracts? Would a more manageable list of accounting and auditing standards make such conflict less likely? What is the "best" arrangement of education and certification for accountants? These are issues that can only be resolved with further study. Future research can focus on specific educational methods that accountants can use to address these issues and revitalize the profession. Additional studies, with a broader cross-section and number of respondents, will be needed to see if the significant factors reported here persist in importance over time. Our study has implications for the governance of publicly-held firms. In the U.S., the Sarbanes-Oxley Act requires both domestic and non-U.S. firms to comply with various governance rules. Firms that do not comply will face both civil and criminal penalties. On the other hand, in most other countries corporate governance matters are based on best practices. The Sarbanes-Oxley Act has changed corporate governance issues significantly. These changes are likely to have considerable impact on the SEC registrant firms, auditors, and on the analyst community. Future research could examine the economic consequences of the passage of the Sarbanes-Oxley Act on the U.S. economy.

المنارة للاستشارات
www.manaraa.com

References

Abarbanell, J. and Lehavy, R., (2003), "Can Stock Recommendations Predict Earnings Management and Analysts' Earnings Forecast Errors?" *Journal of Accounting Research*, 41(1): pp. 1-31.

Abdel-khalik, A., (2002), "Reforming Corporate Governance post-Enron: Shareholders' Board of Trustees and the Auditor", *Journal of Accounting and Public Policy*, 21: pp. 97-103.

Alam, P., Meonske, N., and Pearson, M.A., (2003), "Financial Reporting Integrity: IMA Members Speak Out", *Strategic Finance*, 84(11): pp. 41-45.

Archambeault, D. and DeZoort, F.T., (2001), "Auditor Opinion Shopping and the Audit Committee: An Analysis of Suspicious Auditor Switches", *International Journal of Auditing,* 5: pp. 33-52.

Arens, A. A., Elder, R.J., and Beasley, M.S., (2005), *Auditing and Assurance Services: An Integrated Approach,* Upper Saddle River, N.J.: Pearson Prentice Hall.

Association of Certified Fraud Examiners., (2005), http://www.cfenet.com.

Bartlett, M., (1950), "Tests of Significance in Factor Analysis", British *Journal of Statistical Psychology,* 3, January: pp. 77-85.

Bobek, D.D. and Hatfield, R.C., (2003), "An Investigation of the Theory of Planned Behaviour and the Role of Moral Obligation in Tax Compliance", *Behavioral Research in Accounting*, 15: pp. 13-38.

Brickley, J.A. and James, C.M., (1987), "The Takeover Market, Corporate Board Composition, and Ownership Structure: The Case of Banking", *Journal of Law and Economics,* 30: pp. 161-181.

Brickley, J.A., Coles, J.L., and Terry, R.L., (1994), "Outside Directors and the Adoption of Poison Pills", *Journal of Financial Economics,* 35: pp. 371-390.

Buckhoff, T.A., and Schrader, R.W., (2000), "The Teaching of Forensic Accounting in the United States", *Journal of Forensic Accounting: Auditing, Fraud, & Taxation,* January – June: pp. 135-146.

Byrd, J.W. and Hickman, K.A., (1992), "Do Outside Directors Monitor Managers? Evidence from Tender Offer Bids", *Journal of Financial Economics,* 32: pp. 195-221.

Crumbley, D. L. and Apostolou, N., (2002), "Forensic Accounting: A New Growth Area in Accounting", *The Ohio CPA Journal,* July-September: pp. 16-20.

Cummins, C., (2004), "Shell Again Cuts Reserve Estimate", *The Wall Street Journal*, March 19, p. A3.

Deli, D.N. and Gillan, S.L., (2000), "On the Demand for Independent and Active Audit Committees", *Journal of Corporate Finance,* 6: pp. 427-445.

DeZoort, F.T., Hermanson, D.R., and Houston, R.W., (2003), "Audit Committee Support for Auditors: The Effects of Materiality Justification and Accounting Precision", *Journal of Accounting and Public Policy,* 22(2): pp. 175-199.

Eighme, J.E. and Cashell, J.D., (2002), "Internal Auditors' Roles in Overcoming the Financial Reporting Crisis", *Internal Auditing*, 17(6): pp. 3-10.

Fama, E.F. and Jensen, M., (1983), "Separation of Ownership and Control", *Journal of Law and Economics,* 26: pp. 301-326.

Fields, M.A. and Keys, P.Y., (2003), "The Emergence of Corporate Governance from Wall St. to Main St.: Outside Directors, Board Diversity, Earnings Management, and Managerial Incentives to Bear Risk", *The Financial Review,* 38(1): pp. 1-24.

Gilson, S.C., (1990), "Bankruptcy, Boards, Banks, and Blockholders: Evidence on Changes in Corporate Ownership and

المنارة للاستشارات
www.manaraa.com

Control when Firms Default", *Journal of Financial Economics,* 27: pp. 355-388.
Gleim, I. N., (2005), http://www.gleim.com.

Hermalin, B.E. and Weisbach, M.S., (1988), "The Determinants of Board Composition", RAND *Journal of Economics,* 19: pp. 589-606.

Hermalin, B.E. and Weisbach, M.S., (1998), "Endogenously Chosen Boards of Directors and their Monitoring of the CEO", *American Economic Review*, 88: pp. 96-118.

Investor Business Relations (2001), "Nearly Three-Quarters of Audit Fees are for Non-Audit Work", May: pp. 12-13.

Kieso, D.E. and Weygandt, J.J., (1998), *Intermediate Accounting*, 9th Ed. New York: John Wiley and Sons, Inc.

Klein, A., (2002), "Audit Committee, Board of Director Characteristics, and Earnings Management", *Journal of Accounting and Economics,* 33: pp. 375-400.

McCall, S.M., (2002), "The Auditor as Consultant", The *Internal Auditor*, 59(6): pp. 35-39.

Messmer, M., (2003), "The Sarbanes-Oxley Act: What Does it Mean to Me?" *Strategic Finance,* 84(9): pp. 13-14.

Mong, S., (2003), "Audit Committee Remuneration: Time for Change", *Australian CPA*, 73(2): pp. 69-71.

Mullan, S., (2003), "Assessing New Responsibilities", *The Internal Auditor,* (Feb): pp. 26-31.

Peloubet, M.E., (1946), "Forensic Accounting: Its Place in Today's Economy", *Journal of Accountancy,* 81(6): pp. 458-462.

Phillips, J., Pincus, M. and Rego, S.O., (2003), "Earnings Management: New Evidence Based on Deferred Tax Expense", *The Accounting Review*, 78(2): pp. 491-521.

Ranii, D., (2004), "Dispute Over Stock Options Heats Up", *The News & Observer*, March 28, pp. E1, E3.

Scott, A., (2002), "Aggressive Accounting Practices Examined", *The Internal Auditor*, 59(4): pp. 13-14.

Sunder, S., (2002), "Management Control, Expectations, Common Knowledge, and Culture", *Journal of Management Accounting Research,* 14: pp. 173-187.

Thomas, A.R. and Gibson, K.M., (2003), "Management is Responsible, Too", *Journal of Accountancy,* 195(4): pp. 53-55.

Weil, J. and Tannenbaum, J., (2001), "Big Companies Pay Audit Firms More for Other Services", *The Wall Street Journal*, April 10: p. C1.

Weisbach, M., (1988), "Outside Directors, Monitoring, and the Turnover of Chief Executive Officers: An Empirical Analysis", *Journal of Financial Economics*, 20: pp. 431-460.

Wiedman, C., (2002), "The Power of Auditors", *CA Magazine*, 135(10): pp. 39-42.

المنارة للاستشارات
www.manaraa.com

Appendix One

Financial Reporting in the Post-Enron Era

The recent bankruptcy of Enron has raised serious questions about the integrity of financial reporting. Some have argued that people will be less willing to invest in stocks and bonds of large public companies because accounting numbers disseminated by these entities can no longer be trusted. The Enron failure may be a contagion affecting capital markets and the economy for many years to come. The purpose of this survey is to obtain your perceptions of the appropriate role of various financial reporting participants in the post-Enron era. There are no "right" or "wrong" answers. Your responses will be kept confidential. Only summary data will be reported in presentations or in publications. Please provide a business card if you are interested in obtaining summary data. Thank you for taking the time to complete the survey.

The Reporting Company

1. The management of a company should bear primary responsibility for ensuring the reliability of its financial statements.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

2. Currently, important facts concerning underlying economic conditions are frequently not reported in company financial statements.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

3. Compensation plans that link salary and bonuses with reported earnings cause company managers to manipulate accounting numbers.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

4. The reporting of earnings expectations by financial analysts causes company managers to manipulate accounting numbers.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

5. No member of a company's management should be a voting member of a company's board of directors.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

المنارة للاستشارات
www.manaraa.com

6. The audit committee of a company's board of directors should consist solely of individuals independent of the company's management.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

7. The societal role of company audit committees needs to be strengthened.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

8. Company audit committees should have the power to hire and fire external auditors.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

The External Auditors

9. A company's external auditors should bear the primary responsibility for ensuring the reliability of the company's financial statements.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

10. A company's external auditors should provide a high level of assurance that company financial statements are free of material fraudulent misstatements.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

11. Firms should not be permitted to provide external auditing services and consulting services to the same client company.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

12. Firms that provide external auditing services should not be permitted to provide consulting services to anyone.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

المنارة للاستشارات
www.manaraa.com

13. Requiring publicly owned companies to obtain external auditing services from a different firm every five years is a good idea.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

14. Firms should not be permitted to provide external auditing services and internal auditing services to the same client company.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

Others

15. The Financial Accounting Standards Board has failed to establish adequate accounting standards for new and emerging business transactions.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

16. Intense external pressures have resulted in less-than-timely establishment of accounting standards by the Financial Accounting Standards Board.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

17. The Securities and Exchange Commission should take a more active role in the establishment of accounting standards.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

18. The U.S. Congress should take a more active role in the establishment of accounting standards.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

19. Auditing standards should be established via due process by an independent board similar in structure to the Financial Accounting Standards Board.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

المنارة للاستشارات
www.manaraa.com

20. Financial analysts should be required to disclose whether they own the stocks and other financial instruments they recommend to their clients.

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
1	2	3	4	5

Information About You

21. How long have you been with your current employer? ______________________________

22. What is your current position? ____

23. Please indicate the industry of your employment __________________________________

24. How would you describe your company? (Please check one):
Regional___ National___ Multinational____

25. Have you earned a bachelor's degree? ___ Master's degree? ____ Doctoral degree? ____

CMA? _____ CPA? _____ Other professional certification? _____

Please provide below any thoughts that you have on the subject of "Financial Reporting in the Post-Enron Era." Thank you very much.

المنارة للاستشارات
www.manaraa.com

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

المنارة للاستشارات

www.manaraa.com