

The Influence of Professional Integrity and Client Advocacy on Reporting Decisions

John Hasseldine

University of New Hampshire

NASBA 2013 Western and
Eastern Regional Meeting

PAUL
COLLEGE

PETER T. PAUL COLLEGE OF
BUSINESS AND ECONOMICS

Advocacy vs. Integrity

- The Code of Professional Conduct (AICPA 2010) applies to all AICPA members
- The Code emphasizes the importance of a member's integrity as "it is the quality from which the public trust derives and is a benchmark against which a member must ultimately test all decisions" (AICPA Code of Conduct, Section 54- Article III)
- The AICPA Code also allows a member to act as a client advocate in "support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others" (AICPA Rule 102-6)

Advocacy vs. Integrity

- Prior research on confirmation bias in financial accounting decision making has documented the tendency for some professionals to exhibit pro-client tendencies when client preferences are made explicit
- In contrast, other researchers, in the absence of strong client preferences, have found that experienced professionals tend to report conservative, income-decreasing outcomes
- What effect do the profession's standards for Advocacy and Integrity have?

Advocacy vs. Integrity

Implications for:

- Standard-setters
 - Accountants with competing standards
 - Professors engaging students in applied ethical decision making
-
- The AACSB now requires that students study ethics as a part of their business degree at an AACSB-accredited institution

Codes of Conduct

- Corporate level analysis provides conflicting results:
 - No effect on ethical decision making
 - Codes can be effective, but congruence between stated and enacted values is necessary
- Herron and Gilbertson (2004) compared the effects of principles-based and rules-based Code excerpts on auditor independence assessment. Effect seen when categorizing participants by DIT score
- A code can enhance or limit auditors' ethical sensitivities

Client Advocacy

- Auditors can be influenced by client preferences and tend to permit aggressive reporting by favorably interpreting vague facts and standards
- Similar observations have been made for tax practitioners
- Attitude toward advocacy is positively correlated with favorable recommendations
- Correlation is often small, or, as in Kadous and Magro 2001; Barrick et al. 2004, nonexistent

Combined Counterbalancing Standards

- Contrasting examples draw attention to the relevant components of the underlying principle. Anderson et al. (1990) assert that comparisons are effective because they heighten attention to unique attributes. Implication is that the presentation of countervailing concepts increases comprehension
- Researchers have found that decision makers will use the information that is most readily available
- When given an ambiguous context with unclear technical guidance, exposure to both standards should lead to a neutral response that is not overly pro-client or overly conservative for the facts at hand

Context of Pilot Study

Two decision contexts. Participants are told that the technical guidance is unclear, and then they are asked to decide whether all of the high salary of the president of a company should be deducted as compensation or treated as a dividend.

- One case has scant facts to misinterpret, leaving lack of technical guidance as the source of ambiguity.
- The other case has additional details, requiring more effort to decipher their relevance. Magro (2005) labeled this type of increase in number of components to consider as “task complexity.”

Contextual Information

- Cuccia et al (1995) and Johnson (1993) find that incremental information is likely to be over weighted as confirmatory evidence of a preferred position.
- When decision makers in a financial reporting context have a propensity toward conservative reporting, that propensity should be more conservative in a high context case than in a low context case.

Contextual Information

- In discussing motivated reasoning, Kunda (1990) warns that a participant's motivation may reach its boundary if additional information could be viewed by third-parties as evidence against a targeted position
- The additional constraint from the high contextual information case is expected to dampen the pro-client tendency for the group that had been driven by the advocacy prime

Method – Within Subjects

- Two ambiguous cases differing in contextual information
 - Low contextual information: Shortened version of Johnson (1993) Whether a payment should be deducted as compensation for services provided or not deducted because it is a return of capital to a shareholder.
 - High contextual information: Additional details (adapted from Johnson (1993) and Pinsker (2009)...Family-owned corporation, person elected president after spouse's death, job descriptions, guidance on criteria for deduction (as compensation) and not deducting (if it is treated as a dividend or return of capital).
- Seven-point scale (-3: definitely do not deduct, to +3: definitely deduct)

Method – Between Subjects

- Control
- Integrity
 - “Integrity requires a member to be, among other things, honest, and candid ... Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.”
- Advocacy
 - “A member or a member’s firm may be requested by a client ... to act as an advocate in support of the client’s position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.”
- Advocacy and Integrity
 - Combined Treatment

TABLE 1

Descriptive Statistics for Demographics, Assessments of AICPA Code Excerpts

Age	Mean (SD) = 21.57 (1.94)
Gender	Percent Male/Female = 60.0/40.0
Favorability of Rule 102-6(2) (Advocacy)*	Mean (SD) = 5.04 (1.25)
Favorability of Section 54-Article III (Integrity)*	Mean (SD) = 3.36 (1.33)
Relative Influence*	Mean (SD) = 4.83 (1.55)

Hypothesis 1

Financial reporting decisions for ambiguous contexts will be conservative when subjects are not exposed to the professional standards for integrity or advocacy.

Test: One-sample t-test comparing mean response in the Control group to zero:

<u>Context</u>	<u>Control Mean (SD)</u>	<u>t(df)</u>	<u>p</u>	<u>H1</u>
Low	1.09 (1.54)	3.396 (22)	.002	Supported
High	1.09 (1.89)	2.772 (22)	.006	Supported

Hypothesis 2

Financial reporting decisions made by subjects exposed to a prime for professional integrity will not differ from those made by subjects without any exposure to the professional standards.

Test: ANCOVA comparing reporting decisions in the Control and Integrity groups:

<u>Context</u>	<u>Control</u> <u>Mean (SD)</u>	<u>Integrity</u> <u>Mean (SD)</u>	<u>F (df)</u>	<u>p</u>	<u>H2</u>
Low	1.09 (1.54)	0.77 (1.51)	.255 (1,44)	.616	Supported
High	1.09 (1.89)	0.86 (1.64)	.007 (1,44)	.935	Supported

Hypothesis 3

Subjects exposed to a prime for client advocacy will make less conservative financial reporting decisions than those without any exposure to the professional standards.

Test: ANCOVA comparing reporting decisions in the Control and Advocacy groups:

<u>Context</u>	<u>Control Mean (SD)</u>	<u>Advocacy Mean (SD)</u>	<u>F (df)</u>	<u>P</u>	<u>H3</u>
Low	1.09 (1.54)	0.30 (1.69)	2.928 (1,45)	.047	Supported
High	1.09 (1.89)	1.09 (1.86)	0.034 (1,45)	.854	Not Supported

Hypothesis 4

Subjects exposed to a prime for both client advocacy and integrity will make less conservative financial reporting decisions than those without any exposure to the professional standards.

Test: ANCOVA comparing reporting decisions in the Control and Advocacy & Integrity (A & I) groups:

<u>Context</u>	<u>Control</u> <u>Mean (SD)</u>	<u>A & I</u> <u>Mean (SD)</u>	<u>F (df)</u>	<u>p</u>	<u>H4</u>
Low	1.09 (1.54)	0.09 (1.69)	6.150 (1,66)	.008	Supported
High	1.09 (1.89)	-0.02 (2.05)	4.120 (1,66)	.024	Supported

Hypothesis 5

Subjects exposed to a prime for client advocacy will make less conservative decisions in a low context case than in a high context case.

Test: Paired samples t-test comparing the reporting decision in the low contextual information case to that in the high contextual information case.

<u>Group</u>	Low Context <u>Mean (SD)</u>	High Context <u>Mean (SD)</u>	<u>t(df)</u>	<u>p</u>	<u>H5</u>
Advocacy	0.30 (1.69)	1.09 (1.86)	2.313 (22)	.015	Supported

Conclusion

- This project examines the latent conflict between accountants complying with professional ethics standards and acting as advocates for their clients on ambiguous issues
- Current data collection uses similar experimental method with CPA participants to answer a tax case
- Pilot (with students) incorporates two audit cases with equally unclear outcomes but differing in the level of contextual information

Conclusion

- Student participants are conservative in their reporting decisions
- When participants are exposed to AICPA Rule 102-6 allowing client advocacy, they indicate a less conservative position, but only when the level of contextual information is low
- For participants exposed to Section 54 requiring integrity, the responses are as conservative as those without access to the professional standards

Conclusion

- Simultaneous presentation of both standards results in a neutral position reflecting neither conservative nor pro-client tendencies – robust across changes in the level of contextual information
- Results consistent with the psychology literature on availability, and the literature on cognitive development (which asserts the importance of comparative distinctions for more effective mental processing)
- Professional decision making could be enhanced by a global professional standard that recognizes the need to jointly consider the right to be a client advocate while maintaining the professional standard for integrity

Conclusion

- Ethical guidelines will become increasingly important as the profession adopts more principles-based standards.
- This research should benefit educators by highlighting the fact that accounting majors should study the professional codes and that fundamental standards are not emphasized in isolation of other potentially countervailing standards.
- Caveats:
 - Simplification of a real-world setting
 - Comparability of student responses to those of practitioners