

2006 ANNUAL MEETING

MID-ATLANTIC REGION

AMERICAN ACCOUNTING ASSOCIATION

APRIL 20-22, 2006

PITTSBURGH, PA



CONFERENCE PROCEEDINGS

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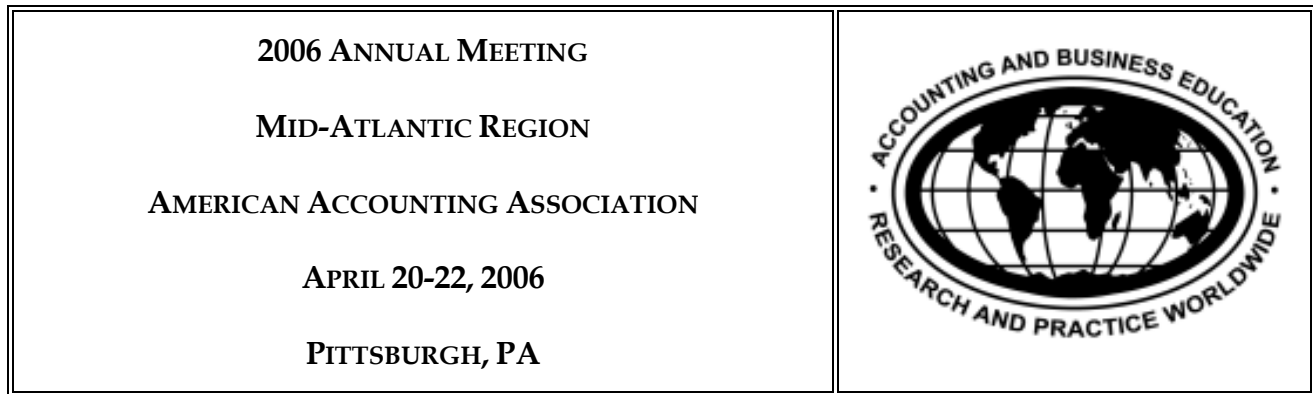
SECTION I.

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PAPER #: CS-3.3.2

TITLE: *A Framing Study: Do Management Accountants and Public CPAs Process Information the Same Way?*

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ABSTRACT

Tversky and Kahneman (1981) demonstrated the framing effect in their famous Asian Disease Problem. Numerous studies in various disciplines have confirmed their results. A recent study by Hughes (2006), however, demonstrated that management accountants may not demonstrate this effect due to problem solving experience in the work place. This paper explores whether the same may be true of Certified Public Accountants working in public practice. CPAs in this study demonstrate the framing effect given a generic scenario. However, CPAs demonstrated mitigation of the framing effect when domain specific details were added.

Key words: framing effect

Data availability: Contact the author

INTRODUCTION

Tversky and Kahneman (1981, 1986) have demonstrated that how information is presented or “framed” can alter the resulting decision even if the information presented is economically equivalent. A recent study by Hughes (2006) demonstrated that management accountants may not be affected by the framing effect due to problem solving experience on the job. The constant request to look at alternatives, evaluate the pros and cons of each alternative, and to defend the chosen solution, appears to mitigate the framing effect by focusing on the defense of the answer rather than the risk of the alternatives. An open question is whether CPAs, having a different occupational focus, would also demonstrate mitigation of the framing effect.

This paper demonstrates that domain specific knowledge may decrease the framing effect for CPAs in public practice, as it did for management accountants in Hughes (2006), but perhaps for different reasons. The remainder of this paper is organized as follows: Theory and Hypothesis Development, followed by, Methods and Experiment, concluding with Results and Discussion.

THEORY AND HYPOTHESIS DEVELOPMENT

The Framing Effect

Kahneman and Tversky (1981) developed the now famous “Asian Disease Problem.” They demonstrated that an economically equivalent problem can elicit different answers from most individuals if the wording is phrased in a positive way or alternatively in a negative way. This is called the Framing Effect. They found that people tend to be conservative regarding gains and less risky toward losses. The issue is one of perception; the perception of a loss vs. the perception of a win.

The Asian disease problem set off hundreds of studies in numerous disciplines in the subsequent decades. Researchers have varying opinions as to the robustness of the framing effect. Kuhberger (1998) summarized 136 empirical papers with experiments studying the framing effect. Kuhberger found significant differences between research designs. He grouped them by: a) manipulation of reference points, b) manipulation of outcome salience, and c) response modes (choice vs. justification provided). This paper examines the manipulation of reference points.

Mitigation of the framing effect has been shown by a written justification of the decision (Miller and Fagley 1991). They also explored the change in risk measures at different probability levels. People demonstrated more tolerance of risk at lower levels. The framing effect has been shown to be reduced when subjects were asked to provide a rationale for their choice (Miller and Fagley 1991; Kuhberger 1998).

Mitigation has also been shown to occur the problem is enhanced with more description of the problem (Jou, et al. 1996). This reduces ambiguity. Jou found wide variety in the strength of the effect due to variation in the subject in the problem, variation in the elaboration of the problem scenario, and variation in the experimental design (Jou, et al. 1996). Hughes (2006) found results may also vary as a result of the population characteristics of the subjects. Population characteristics in framing studies have not been extensively documented, unfortunately.

The variety of problem manipulations in the library of framing studies makes it difficult to compare them. Further, if population characteristics do influence the strength of the framing effect, then it is important to study the framing effect in domain area relevant to the subject. How does the CPA in public practice make his decision in a procedurally reasonable way using his available knowledge? CPAs look to see generally accepted accounting principles have been used, and are tasked to evaluate new data from that perspective. Rather than constantly choosing between alternatives, which is the case for management accountants, CPAs are more likely to compare a novel approach against the standard methodology. Expert studies show beginning CPAs to use sequential processing to understand and search, while more experienced auditors can retrieve information more directly (Frederick 1991).

Knowledge Structures

If knowledge acquisition is dependent on the interaction of experience and ability (Frederick 1991; Libby 1995), then variation in the subject pool should have significant effects on the existence of and content included in knowledge structures. Hughes contends (2006) it is possible that those with normatively valid knowledge structure will ignore framing effects caused by the anchoring of gain or loss positions, and instead view the problem from the methodology used in their everyday occupational. Knowledge structures for CPAs may be very different from management accountants, yet both groups share general accounting knowledge.

Jou et al. (1996) cites Cheng and Holyoak (1985) as demonstrating that subject's performance on selection problems could be substantially improved if the problem is imbedded in a familiar schema that provided a rationale for the rule. They point out that you can only use a knowledge structure if you have one, therefore, a problem may seem transparent to you, while not transparent to others without the same way of processing the information. Cheng and Holyoak's (1985) results supports Hughes' (2006) hypothesis that the experience of the management accountant is expected to develop a problem forming knowledge structure which sorts the data into a familiar problem structure which guides the steps to solution. In this way,

management accountants will cognitively contrast the choices rather than make a choice based on an anchored reference point affecting their choice under risk.

John Anderson (1992) describes three types of knowledge: declarative knowledge consisting of basic factual knowledge about the domain; knowledge structures that organize the basic factual knowledge around underlying principles or categories; and procedural knowledge consisting of stored information about if-then rules that provide situation-specific solutions to problems. Both CPAs in public practice and management accountants will have broad accounting domain experience and varied specialized accounting domain experience. Management accountants should have in common the generic task of assisting management make decisions. Most will be familiar with the task of looking at alternatives, providing the advantages and disadvantages of each and providing a rationale for a choice. Therefore, nearly all should have a knowledge structure for problem solving. This behavior is unique to management accountants and is not likely found to the same degree in CPAs in public practice.

How then might CPAs in public process information in a framing study, both in the generic form, such as the Asian Disease problem, or an isomorph of it, and in a professionally relevant form?

In auditing, Bonner et al. (1996) and Tubbs (1992) have demonstrated that experience in a domain develops strong knowledge-structures. Vera-Munoz, et al. (2001) demonstrated that management accountants performed better than public accountants on a task that benefited from specific domain experience. It is reasonable to assume CPAs will perform better than management accountants when the content is more relevant to the work experience of the CPA. Vera-Munoz, et al. (2001) posited that various types of management accounting, taxation, information technology, and systems experience may help accountants better perform one type of domain specific tasks, while financial accounting experience may help accountants perform other kinds of tasks. It is very possible that CPAs have developed a knowledge structure that will compare any decision to the standard practice, and might well ignore the framing effects observed in other populations.

Bias Studies

Most studies on framing effects and other biases start by demonstrating the existence of the bias and then proceed to identify procedures which will mitigate the bias. Kennedy (1995) extended the framing literature by focusing on mitigating biases by using the external stimulus of accountability, experience, and contra-explanations. Perhaps due to the experimental nature of the study, she did not demonstrate accountability and experience effective in mitigating bias. Other studies (Smith and Kida 1991) have shown accountability and experience to be effective in mitigating bias. Kennedy (1995) did show the elimination of bias when contra-explanations were used. This is consistent with most framing studies when subjects were asked to provide a rationale for their choice (Miller and Fagley 1991; Kuhberger 1998). Hughes' (2006) paper is based on the assumption that management accountants have developed a problem solving knowledge structure as a result of repeated assignments to make management decisions, which include reviewing with their superiors the alternatives chosen, the advantages and disadvantages of each option, and the recommended course of action. It is assumed that all management accountants would develop this knowledge structure in the course of the job duties, since it is a generic task for their profession.

How do CPA's compare? They too, are subject to review by supervisors, and the effectiveness of their arguments affects their evaluations and promotional opportunities. By their profession alone, auditors will focus on reduced risk and are well aware of the legal penalties to firms that are sued by their clients for poor guidance.

Hypotheses Development

CPAs, in general, attest to the fairness and accuracy of prepared financial statements, as well as the adequacy of internal controls. This is different from choosing between alternatives. If there is a dominant knowledge structure used in making choices, it is not likely to be the same one as used by management accountants. However, the process which CPAs use, based on their training and experience, will lead them

through an evaluative process through alternate paths to reach a decision. According to the expertise literature this knowledge structure formation and use is what makes experienced individuals perform better than novices. Frederick (1991) demonstrated that more experienced auditors could recall more internal control attributes than less experienced auditors.

If CPAs develop a knowledge structure which causes them to compare and contrast information to know standards before making a decision, it is likely that CPAs will not be susceptible to the anchoring which causes the framing effect demonstrated by Kahneman and Tversky. The first hypotheses tests whether CPAs in public practice demonstrate a framing effect on a generic task. The second hypotheses tests whether CPAs in public practice demonstrate more framing effect than management accountants in Hughes (2006). The third hypotheses tests whether domain specific information mitigates the framing effect for CPAs in public practice.

H1: CPAs in public practice will demonstrate a framing effect on a generic task.

H2: Certified Public Accountants in public practice will demonstrate more framing effect than Management Accountants in the Hughes (2006) study.

H3: Certified Public Accountants in public practice will demonstrate more framing effect than Management Accountants from the Hughes (2006) study on accounting domain task.

METHOD

Subjects

The subjects for this experiment were 60 certified public accountants from New Jersey participating in a state sponsored CPE course. All participants volunteered to take the questionnaire. All were working in public practice, although some had previous work experience outside of a CPA firm.

Subjects for the Hughes (2006) experiment on management accountants experiment were 60 management accountants from a large U.S. pharmaceutical company with multiple divisions that sometimes transfer products or services. The management accountants included 25 financial analysts, 19 financial managers, and 16 financial directors from one pharmaceutical company. Many of the subjects have rotated between financial positions that support the marketing, sales, and manufacturing functions, but all work in the domestic pharmaceutical division. Data from Hughes (2006) was used as a comparison to CPAs in this study.

Task

CPA subjects were told that this was an experiment in decision making, that the exercise has no wrong or right answers. Two forms of the instrument (positively framed and negatively framed) were administered subjects as a between subject design. The instrument contained two questions, the first one generic in nature, the second contextually significant for accountants. Subjects were randomly assigned to one of the two forms of the questionnaire.

Experimental Design

The research method employed in this study is an experimental between subjects design. The independent variable is the version of the instrument administered, and the dependent variable the responses of the CPAs. A positively framed version of the instrument is used for one group while a negatively framed wording is used for the other group. The responses of CPAs were compared with responses from the previous study of management accountants using the same instrument by Hughes (2006).

Those responses for Plan A (the riskless option) were assign a value of +1, while all choices for Plan B (the risky option) were assigned a value of -1. The Chi Square measure was computed. See Table 1.

Comparisons were made to previously done studies by Tversky and Kahneman (1981), Fagley and Miller (1987), and Hughes (2006). See Table 2.

Instrument

The instrument used in this study was the same instrument used by Hughes (2006) to test for the framing effect on management accountants. To test whether management accountants were less susceptible to the framing effect than non-management accountants, an instrument was developed which included a framing experiment within the context of a management accounting task. The first question replicated a previously studied framing problem developed by Bazerman (1998), the Plant Closing Problem. This is an isomorph of the famous Kahneman and Tversky Asian Disease problem. Hughes (2006) developed an additional question in a more context relevant task to test whether occupationally related cues caused a management accountant to behave differently as the result of a knowledge structure used at work to evaluate problems. If an accountant did not demonstrate reduced framing effect on a generic problem (Question 1), he may still demonstrate less framing effect in a contextually relevant accounting problem, such as Question 2.

Question 2 in the instrument expanded on Question 1 (the plant closing problem) by providing details about two different plans to save the manufacturing plants and the jobs of the employees. The solutions related to bringing in extra work from another division to absorb costs and keep people busy. Subjects are given a choice between using tight and loose assumptions to calculate the transfer price, with the looser calculation being more risky, but with a higher number of jobs saved if it worked. This question provided a contextually relevant arena to test the framing effect on management accountants. CPAs could be in a position to audit the transfer price methodology and could compare choices made to established practice.

Internal and External Validity

Question 1 on the instrument has been already tested for the framing effect by Bazerman, (1998), Fagley & Miller (1985), and Hughes (2006). Although not as strong as those by Kahneman and Tversky or Bazerman, internal validity was demonstrated on Question 1 and extended to Questions 2 in Hughes (2006). External validity is supported by surveys by Wu and Sharp (1979) and Tang (1979). They documented the dominant practice of cost-based transfer pricing between manufacturing divisions as a result of no external market pricing readily available.

Design and Analysis

This study replicates the experiment done by Hughes (2006), the only change being the testing of CPAs in public practice rather than management accountants. Given the small size of the samples, and the proportional nature of the data, Chi Square was used, replicating Hughes (2006).

Expected Results

CPAs are expected to demonstrate the same framing effect observed by Bazerman on this question. That is, approximately 80% of the CPAs who are answering the positively worded question will choose plan A (riskless option), while only 20% of the CPAs who answer the negatively worded question will choose plan A. It is expected that the CPAs will demonstrate a similar framing effect than demonstrated by general populations in the Tversky & Kahneman (1981) and Fagley & Miller (1987) research results. It is expected that the CPAs will demonstrate more framing effect than the management accountants in Hughes (2006).

If the CPAs have a knowledge structure, as hypothesized in Hughes (2006), to management accountants a knowledge structure is developed as the result of experience in accounting areas, accountants compare and contrast alternatives. This comparison process would mitigate the anchoring which has been theorized to cause the framing effect. It is expected that there will be a smaller framing effect by management accountants than CPAs in Question 1, because it is not clear that CPAs use the compare and contrast function as much as the management accountants.

This knowledge structure should be even stronger when domain specific details are entered into the same problem (as in Questions 2). It is hypothesized that the framing effect will be reduced for the CPAs but not as much as the management accountants.

RESULTS

The results of this study show that CPAs demonstrated the framing effect on a generic task in Question 1. Management accountants in Hughes (2006) did not demonstrate this effect. However, the framing effect was mitigated for both CPAs and management accountants when a question contained job-related cues (Question 2).

Table 1 shows the result for management accountants as a group and CPAs as a group. Management accountants have the lowest percent differences between frames (12%, and 5%) as compared to CPAs (40%, and 13%). On the first question, the Chi Square test was significant for CPAs ($p = .002$), causing the rejection of the null hypothesis while demonstrating the framing effect. The framing effect on the management accountants was not significant ($p = .355$), supporting the null hypothesis. In Question 2, the management accountants results support the null hypothesis ($p = .563$). In Question 2 the CPAs support the null hypothesis with a $p = .258$. The insertion of domain specific elaboration reduced the framing effect to a level of significance. With no demonstrated intervening variable on Question 1, it is expected CPAs would choose the riskless choice in form "save" and the risky choice in the "lose" form to prevent loss. The results demonstrate this occurring. However, the lack of framing effect in Question 2 demonstrates that accounting domain specific detail mitigates the framing effect.

DISCUSSION

CPAs in public practice have different work experiences and different problems to solve. The problem solving schema developed by CPAs might be the comparison to a perfect standard, rather than a comparison between two equal alternatives. This might explain the magnitude of the difference between working management accountants and CPAs in public practice. Since the CPAs demonstrated no significant framing effect on question 2, there had to be an intervening variable to explain this result.

Supporting the idea of a problem solving knowledge structure is the fact that Fagley and Miller (1987) found no framing effect when MBA students were asked a framing question and asked to provide a rationale, but found a significant framing effect on students from a school of education given the same test and also requested to provide a rationale for choice. This implies that although a rationale request might trigger a problem solving knowledge structure and eliminate the anchoring on a gain or loss perspective, it does not necessarily do this if no knowledge structure for a compare and contrast process is available. It also highlights the importance in evaluating sample characteristics such as occupation, training, and gender prior to making statements of generalizability in bias studies.

Many studies on the framing effect have looked at alternative ways of mitigating the effect. This has been done by manipulating the problem, either by changing the ratios, elaboration of the wording, or by asking for elaboration in the answer. This study shows that mitigation of the framing effect can occur without changing anything, replicating Hughes (2006). By looking at the responses of CPAs and management accountants we see that a mitigating variable is responsible for the significant decrease in the framing effect.

This paper posits that a knowledge structure for problem solving has been developed by the accountants that have not been developed in the general public. It further demonstrates that domain specific knowledge decreases the framing effect. This may not be true for other biases.

Where the framing effect does exist, as it appears to in junior staff, it is wise to use the debiasing techniques outlined by Kennedy (1995) as well as Bazerman's (1988) development and application of criteria to rank alternatives. Both appear to accept the cognitive complexity of solving problems without these tools, or else these tools & techniques would not be necessary.

This paper makes two distinct contributions to research. The first is an extension of theory in the framing effect literature. This paper demonstrates that not all subjects are equal. If accountants do not demonstrate the same framing effect as other studies, and other groups, such as education majors, then increased documentation of subject characteristics is important to understand the dynamics of heuristic and bias experimental results. Internal cognitive processes affect the thought process in making choices. Intuitively, training and experience should affect results. The second is to identify a specific knowledge structure applicable to CPAs in public practice that may not exist for other occupations.

APPENDIX

Plant Closing Decision Instrument

(Form S)

1. Your company, a large manufacturer, has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans:

Plan A: This plan will save one of the three plants and 2,000 jobs.

Plan B: This plan has a 1/3 probability of saving all three plants and 6,000 jobs, but has a 2/3 probability of saving no plants and no jobs.

Which plan would you select? _____

2. Your company, a large manufacturer, has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans. Both Plan A and Plan B involve providing production work for another division of your company. This other division has received a huge order on a new product that they can not fill in their present plants. You have been asked to provide a cost estimate (transfer price).

Under Plan A, you would provide a transfer price offer at the same cost (transfer price) that you would do the work for your own division. Your cost estimate should be cheaper than the other division's estimate since you have larger scale equipment, and therefore benefit from economies of scale. The additional contribution (absorption) from this extra production would be sufficient to save one of the three plants and 2000 jobs.

Under Plan B, you would provide a transfer price offer at a different cost (transfer price) than you would if the work was for your own division. The cost would be higher. You would be more conservative in your estimates, allowing for more scrap, lower output yields, slower running machine speeds, and higher estimate of utilities. You would try to bring the cost up to meet what you think the other division could do it for, if it had the capacity. There is a 1/3 probability the other division will not object to the transfer price and all three plants and 6000 jobs will be saved. However, there is also a 2/3 probability the other division will reject the transfer price and seek an outside manufacturer. As a result you will save no plants and no jobs.

Which plan do you select? _____

(Form L)

1. Your company, a large manufacturer, has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans:

Plan A: This plan will result in the loss of two of the three plants and 4,000 jobs.

Plan B: This plan has a 1/3 probability of losing no plants and no jobs, but has a 2/3 probability of resulting in the loss of all three plants and all 6,000 jobs.

Which plan would you select? _____

(Form L)

2. Your company, A large manufacturer, has recently been hit with a number of economic difficulties, and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans. Both Plan A and Plan B involve providing production work for another division of your company. This other division has received a huge order on a new product that they can not fill in their present plants. You have been asked to provide a cost estimate (transfer price).

Under Plan A, you would provide a transfer price offer at the same cost (transfer price) that you would do the work for your own division. Your cost estimate should be cheaper than the other division's estimate since you have larger scale equipment, and therefore benefit from economies of scale. The additional contribution (absorption) from this extra production would reduce the economic problem and you would lose only two of the three plants and 4000 jobs.

Under Plan B, you would provide a transfer price offer at a different cost (transfer price) than you would if the work was for your own division. The cost would be higher. You would be more conservative in your estimates, allowing for more scrap, lower output yields, slower running machine speeds, and higher estimate of utilities. You would try to bring the cost up to meet what you think the other division could do it for, if it had the capacity. There is a 1/3 probability the other division will accept the transfer price and not seek an outside manufacturer. As a result you will lose no plants and no jobs. However, there is also 2/3 probability the other division will object to the transfer price and all three plants and 6000 jobs will be lost

Which plan do you select? _____

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Table 1. Difference in sample testing and percent choosing the Riskless Option, by Problem, Framing Condition, and Group

Problem	Group	N	Form S	Riskless Choice Form S	Form L	Riskless Choice Form L	Delta	χ^2	χ^2 Sig.
1. Job Layoff	Mgmt Accts	60	29	86%	31	74%	12%	1.4	P=.355
	CPAs	60	30	87%	30	47%	40%	9.348	P=.002
2. Transfer Price Choices	Mgmt Accts	60	29	86%	31	81%	5%	.33	P=.563
	CPAs	60	30	80%	30	67%	13%	.877	P=.258

* $p < .05$; ** $p < .01$

Table 2: Comparison among Studies of Percentage Response by Positive or Negative Frame

	<i>n</i>	<i>Riskless Option</i>	<i>Risky Option</i>
Tversky & Kahneman (1981) Asian Disease problem			
<i>Positive</i>	152	72%	28%
<i>Negative</i>	155	22%	78%
Fagley & Miller (1987) cancer treatment problem			
<i>Positive</i>	44	82%	18%
<i>Negative</i>	42	48%	52%
Hughes (2006) Management Accountants job layoff problem			
<i>Positive</i>	29	86%	14%
<i>Negative</i>	31	74%	26%
CPAs job layoff problem			
<i>Positive</i>	30	87%	13%
<i>Negative</i>	30	47%	53%

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2006 ANNUAL MEETING

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AMERICAN ACCOUNTING ASSOCIATION

APRIL 20-22, 2006

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PAPER #: CS-4.2.2

TITLE: *The Impact of the Sarbanes-Oxley Act of 2002 on the International Business Community*

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ABSTRACT

The Sarbanes-Oxley Act of 2002 has been the root of much discussion and debate over the past three years. It imposes additional burdens on doing business in an effort to make the firm and its executives more accountable for the corporate governance, business operations, and financial reporting of the company. The purpose of this paper is to present a brief, recent history of efforts to regulate corporate governance around the world; present the key provisions of the Sarbanes-Oxley Act of 2002; and discuss the impact of this Act on global business on their operations and reporting worldwide. The paper concludes with some open-ended questions left unanswered which, over time, will be answered based on the future responses to the Act.

INTRODUCTION

The accounting scandals of the recent decade have had a major impact on corporate governance as we knew it, for "when seismic events shake investor confidence in large international corporations, the worldwide landscape of public company governance changes" (Green and Gregory, 2005 p. 48). The fact that a ripple effect can cause a company heart burn and consternation is often overlooked in a climate where globalization has resulted in thousands of public companies doing business in different foreign jurisdictions. The result of this globalizing force is that global firms must research the laws of each jurisdiction in which they do business and retain local experts to ensure compliance. This obviously creates a significant financial burden for firms intending to enter global financial markets.

SARBANES-OXLEY ACT OF 2002

Corporate Accounting Practices Act, more commonly known as the Sarbanes-Oxley Act of 2002 (“SOX”) was passed by Congress on July 30, 2002 in response to the corporate scandals of the late 1990’s early 2000’s. Its purpose was to restore public confidence in the markets after this confidence was weakened by these scandals (Green and Gregory, 2005, p. 50). Accordingly, the major provisions of SOX include:

1. The principal executive officer and principal financial officer must certify the financial statements of the company;
2. The company must document its internal control systems;
3. The audit committees of the boards of directors must be composed of independent directors and establish “whistleblower” policies to allow questionable accounting practices to be anonymously reported; and
4. Public companies are to adopt and disclose a code of ethics for its key executives (Green and Gregory, 2005).

SOX also drew upon listing standards of the New York Stock Exchange and National Association of Securities Dealers to establish additional governance and reporting requirements for the firms (See Green and Gregory, 2005, p. 50-51). These additional governance and reporting requirements include: (a) creating more accountability for auditor independence; (b) requiring audits of internal controls in addition to those already required of financials statements; (c) limiting the use of pro forma financial information in various ways; and (d) setting minimum standards for professional conduct for attorneys representing issuers in any way before the United States Securities and Exchange Commission (SEC) (See Cohen, Bronson, Edwards and Stegemoeller, 2004 and Madrid, 2004).

Senator Sarbanes, one of the sponsors of the SOX legislation, was clear in the Senate floor debates of his intentions when lobbying for passage of his proposed legislation. He emphasized “simple principles” which are adopted by the SEC in their final regulations illustrated by Ainsworth (2004) as follows:

...the principles of independence with respect to services provided by auditors are largely predicated on three basic principles violations of which would impair the auditor’s independence:

- An auditor cannot function in the role of management;
- An auditor cannot audit his or her own work; and
- An auditor cannot serve in an advocacy role for his or her own client.

RECENT HISTORY OF REGULATION OF CORPORATE GOVERNANCE

SOX is not the first attempt to reform corporate governance. Green and Gregory (2005) outline several recent pieces of international legislation aimed at corporate governance. The United Kingdom (UK) explored reform through the adoption of the Cadbury Code (later called the Combined Code) by demanding firms either comply with the regulations or explain and justify their divergence from it. Later in the 1990’s, the Paris-based Organization for Economic Co-operation and Development published its *Principles of Corporate Governance* as a guide for policy-makers, corporations, and other bodies. Similarly, corporate crises in Asia stimulated a move for reform during the same period. Additionally, the *King Report on Corporate Governance for South Africa – 2002* was adopted to provide a governance framework for companies listed on the Johannesburg Stock Exchange. Furthermore, rights of minority shareholders remain the most visible issue for Latin American markets, yet enforcement is inconsistent across its nations. However, none of these efforts has received as much attention or criticism as the demands instituted by SOX. In fact, the implementation of SOX and its tougher regulations has become the benchmark for many as the best practices in corporate governance (Birchfield, 2004). This best practices benchmark is illustrated by (a) the European Union’s (“EU”) efforts to phase in its own regulation of corporate governance in 2004 through several reforms related to director independence and executive

compensation disclosures (Green and Gregory, 2005, p. 50) and (b) the Canadian securities regulations implemented in 2004 which were similar to SOX (Kraeker and Ritchie, 2003).

GLOBAL RESPONSE TO SOX

Corporate governance is an animal largely dictated by local laws. Therefore, since the laws that regulate corporate governance differ among countries, it is not surprising that corporate governance practices differ among countries as well (See Green and Gregory, 2005, p. 49). Not only do the practices differ among countries, they also differ within countries based on the various needs of the organizations involved. In fact, past practice in the EU has been that corporate regulation and oversight of auditors were conducted at the national level, resulting in little conformity among the member states. In May, 2003, however, the EU offered a plan aimed at improving corporate governance and audits among its member states. However, unlike the mandate of SOX, the EU plan adopts the “comply or explain” approach of the UK’s Combined Code.

Green and Gregory (2005) point out that “[r]ules, regulations, and norms around the world influence the way public companies operate globally” (p. 48). Although the EU has begun to harmonize governance and audit regulation, the European Commission has expressed concern to both the European Council and the European Parliament about the “unnecessary outreach effects” of SOX on European companies and auditors as well as the failure of the United States (U.S.) to “mutually recognize the equivalence of high quality regulatory systems” (Green and Gregory, p. 54).

In 2003, the French authorities overhauled their regulatory system against insider trading through the Financial Security Law but did not follow the tough tactics instituted by the U.S. (Cafritz and Gillespie, 2003). French penalties are generally lower and, of 11 defendants charged with insider trading who were convicted and had their convictions upheld on appeal since 1991, five were fined less than the profits they realized and only two were imprisoned for their crimes. Additionally, while SOX increased the SEC budget by approximately 50%, France’s Financial Security Law did not increase financial support to its regulatory body. (Cafritz and Gillespie)

Cafritz and Gillespie (2003) note that French corporate culture may be more resistant to insider dealing, thereby reducing the inclination of the French legal system to engage in “extravagant prosecutorial campaigns” such as those that recently have taken place in the U.S. Additionally, New Zealand realized that it could not afford to wait for its own scandals to begin implementing prescriptive regulation. In addition, it realized the importance of New Zealand companies participating in the global economy. Lastly, Canadian securities regulators proposed rules similar to SOX which were implemented in 2004 (Kraeker and Ritchie, 2003).

GLOBAL IMPACT OF SOX

On Foreign Issuers

The global impact of SOX is apparent by the fact that the U.S. capital markets account for about 60% of the world’s capital markets (McCall, 2004). Firms that must comply with SOX include all firms who: (a) have registered securities under the Securities Exchange Act of 1934; (b) are required to file reports under Section 15(d) of the Securities Exchange Act of 1934; or (c) have filed a registration statement under the Securities Act of 1933 that has not yet become effective are subject to SOX (Cohen *et al.*, 2004). Not only are foreign issuers required to comply, but foreign auditors are also required to meet the SOX requirements when working on firms that fall under its jurisdiction (Ainsworth, 2004). Most important to the purpose of this paper is that there is no exemption or accommodation made for foreign entities in SOX (Green and Gregory, 2005 p. 51). Therefore, these foreign entities which are listed on U.S. exchanges or traded in U.S. markets (whether or not listed) must meet the same standards set by SOX for U.S. firms (Cohen *et al.* 2004). Not only must a firm meet the requirements of SOX, but its affiliates must meet the requirements as well (Briault, 2004). Briault notes that

any multinational firm in Germany with a U.S. company in its group “must obtain internal audit committee approval for any tax advice its auditor wishes to provide” (p. 8). This means that close affiliations between accounting firms and law firms around the world must be closely monitored to prevent violation of the SOX restrictions.

The only way to avoid the provisions of SOX is for the firm to de-register their securities. This requires the firm to de-list from all national stock exchanges and certify that it has less than 300 U.S. shareholders. Due to an increase in the number of foreign issuers listed on U.S. markets indicating they will consider de-listing to avoid the burdens of SOX and other regulations adopted therewith, the SEC has aimed to loosen restrictions on the public offering process by merging the framework for raising capital with reporting (*International Financial Law Review*, 2004). Despite the pending implementation deadline imposed by SOX, as of November 2004, Marshall and Heffes (2004) noted that of the 1,300 companies listed as foreign registrants (most of which are European) in the U.S. markets seven in ten European companies were only in the early stages of planning their SOX internal control projects (p. 10). Many firms argued that they found it difficult to balance SOX compliance efforts with prospective International Financial Reporting Standards and local government regulation in their home country (Marshall and Heffes).

On Doing Business Globally

Not only is SOX affecting foreign issuers, but the internal control requirements add complexity to managing import-export operations and global supply chains (Field, 2004). One example presented by Field (2004) is that a firm may be deemed in violation of SOX if the firm is notified by the U.S. Customs Service that an international trade law has been violated and the firm had no policy or procedure in place to review trade compliance. Not only must the firm have controls in place to comply with U.S. trade laws, it must also be sure it is in compliance with trade laws in all countries with which it does business (Field, p. 56). Therefore, firms are not only required to comply with the provisions of SOX, but the internal control requirement imposed by SOX “ties together all other applicable bodies of law that bear on corporate conduct [and] requires that management know what these requirements are” (Field, p. 55).

Additionally, Field (2004) notes the provision requiring companies disclose to auditors all “off balance sheet transactions, arrangements, obligations and other relationships” essential to the business imposes a heavy burden on supply-chain managers. This provision requires that these managers be aware of and disclose all relationships or service contracts, including the responsibilities under such agreements and potential penalties should the company fail to fulfill its obligation (Field, p. 55). In essence, “[t]he legislators have taken ‘ignorance’ as a defense away in the future” (Birchfield, 2004). This particular component of SOX implementation is one that was somewhat overlooked in the early stages as companies were so preoccupied with the implementation of the basic provisions of SOX, resulting in a situation where they had not even begun applying SOX to their global supply chains two years after the passage of the legislation (Field, p. 56). Additionally, it is difficult for senior managers to know all of the company’s international trade efforts to properly understand how SOX applies in this area. Not only is the implementation of all of these controls costly, the mandate that the internal controls then be audited and certified by the independent auditor adds to the financial burden of doing business globally. Field notes, however, the effect of this is to essentially mandate good management as the document flow and process that must be used to make the company SOX-compliant is very similar to ISO 9000 standards. In many ways, therefore, it is just a good, common sense way of doing business.

One problem the SOX requirements create is the possible detriment to the company as a whole. Internal controls are a form of risk management and risk management, taken to an extreme, can become risk avoidance and, therefore, a risk in and of itself (Birchfield, 2004). One might argue, however, that this has created a division between public and nonpublic (also known as private) companies rather than large and small companies (Cheney, 2004, p. 20). Standards applied by many national and international jurisdictions tend to focus on the most common denominator and, thus, apply to international public companies that sell equities in other countries. Therefore, one could argue the private company has a financial, and therefore possibly a

competitive advantage over public companies entering foreign markets as private companies are not burdened with the extensive reporting and audit requirements of public companies imposed by SOX when doing so.¹

Cheney notes that “[a]bout half of America’s economic output is generated by millions of nonpublic companies, yet FASB [the Financial Accounting Standards Board] writes standards primarily for the complex finances of about 15,000 public companies, establishing the GAAP [generally accepted accounting principles] that the SEC requires for listing on U.S. stock exchanges” (p. 20). The same analysis can be made about applying SOX and the burdens it creates. It is interesting to note that most countries require private companies to file reports under the national GAAP (i.e. the accounting principles generally accepted in that country) while the U.S. does not, yet national GAAP in these other countries as it applies to small companies is not as rigorous as that of international or U.S. standards imposed on public companies (Cheney p. 22).

CONCLUSION

Is the U.S. attempting to impose its laws on firms around the world? Based on the discussion above, it has come pretty close, at least as to those firms over which it can impose jurisdiction, even if based on the smallest of connections to the U.S. Yet, does not the U.S. have a vested interest in protecting investors within its borders? Or has the U.S. stepped over the line by implementing a law that has “unnecessary outreach effects”? These questions are questions that continue to be asked by the U.S. and global investment communities and will only be answered after years of research on the impact, effect, and legacy of SOX.

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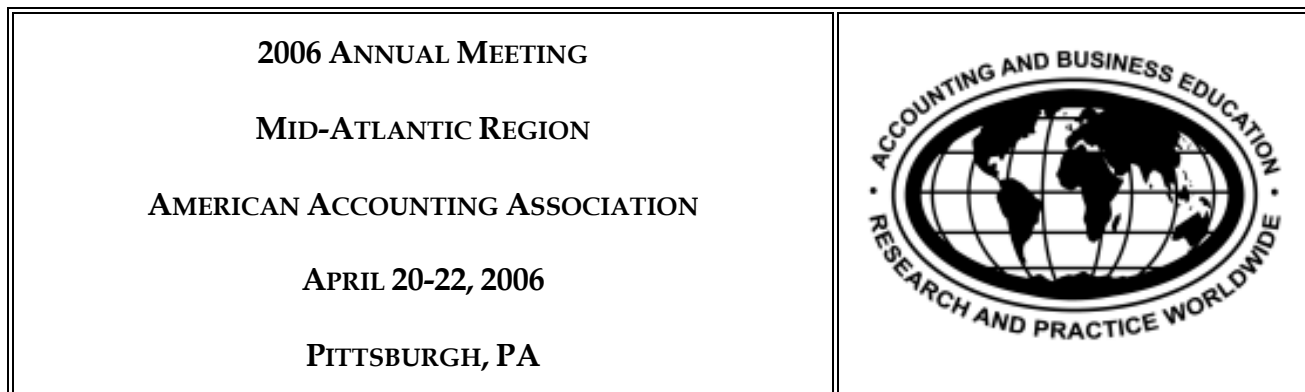
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¹ It should be noted that, as pointed out by a reviewer, the hardships outlined here on public companies are there specifically to provide a protection to stakeholders of the public company and, therefore, should be viewed in this light.

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PAPER #: CS-4.2.1

TITLE: *Sarbanes-Oxley Act and the Redistribution of Revenues among the Big 4 CPA Firms*

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ABSTRACT

The years 2001 and 2002 saw an outbreak of corporate financial scandals that affected millions of investors and evaporated billions of dollars from the market. An important consequence of this phenomenon was the passage of Sarbanes-Oxley Act of 2002 (SOX) that made sweeping changes in the area of corporate governance and affected the way auditor firms received remuneration from their client companies. The study in this manuscript examines the auditor remuneration paid in FY 2001 and FY 2004, by a sample of very large public companies, each with reported annual revenues over \$10 billion for both years, to determine how these new regulations have affected the compensation received by the Big 4 CPA firms. The results of this research show that since the passage of SOX, the Big 4 CPA firms have received a major portion of their compensation in the form of audit fees and the rest mostly in the form of audit-related and tax-related fees. More importantly, since the new legislation became effective, there has been a major change in the proportions in which each of these Big 4 CPA firms receives its revenue from the four different components of auditor remuneration.

BACKGROUND

Since the SEC (2000), via Release 33-7919, began to require publicly traded companies to disclose information pertaining to the non-audit services purchased from their auditors during the fiscal year, the information about fees paid to auditors for the major types of non-audit services became publicly available. As a result, the readers of the proxy statements also discovered that the amount of fees paid to auditors for services in addition to the audit work had reached phenomenal levels. A major portion of these non-audit fees was paid for *other or miscellaneous services*, some of which consisted of fees for “non-financial information system design and implementation services” also referred to as consulting services in the past. Other important sources of non-audit fees were (i) financial information systems design and implementation (FISDI) services that later were banned by Sarbanes-Oxley Act (2002); (ii) audit-related fees for matters such as the review of the company’s financial statements and independent assessment of controls related to outsourcing services or merger/divestiture-related activities; and (iii) tax-related fees that included fees for tax planning, tax advice and tax compliance.

A few of the studies published in the early 2000s indicated that the evidence regarding the relationship between non-audit service fees and auditor independence still is mixed and non-conclusive. While some studies claimed that, there is a relationship between non-audit fees and perceived auditor acquiescence (Frankel et al., 2002; Dee et al., 2002; Firth, 2002); others claimed that no such relationship exists between the two variables (DeFond et al., 2002; Raghunandan, 2003; Ashbaugh et al., 2003; Geiger and Rama, 2003). Regardless of what the empirical research in this area suggests, the issue of large non-audit service fees, combined with the public outcry against the failures of some large public corporations led Congress to pass Sarbanes-Oxley Act (SOX) in 2002 that included certain provisions intended to curb the perceived *fee-dependence* of auditor firms on their audit clients. For example, three sections of SOX, sections 201, 202 and 404 are likely to have a significant impact on the compensation patterns of all CPA firms that provide services to the publicly traded companies.

Section 201 specifically prohibits auditors of publicly traded companies from providing certain non-audit services to their audit clients². This prohibition on the non-audit services could cause a significant dip in the revenues of the CPA firms that serve the publicly traded companies. Besides, Section 202 of SOX requires public companies to obtain pre-approval of their audit committees prior to buying auditing services and certain non-prohibited non-audit services (e.g. tax-related services) from their auditors. However, this pre-approval requirement is waived if the total amount of non-audit services provided to the company does not exceed five percent of the total compensation paid to the auditor by the company during the fiscal year (Kopel 2003). Therefore, it is expected that in order to avoid the pre-approval requirement, auditor firms may try to keep the non-audit service revenues component of their total remuneration below the required limit of five percent of total revenues from the company.

Section 404 of SOX, followed by the SEC Final Rule 33-8238 (2003), requires a publicly traded company to include in its annual report an “internal control report” containing a statement about the responsibility of the management for establishing and maintaining adequate internal control and procedures for financial reporting. The report also has to include the management’s assessment of the effectiveness of the said internal control. Further, the same section also requires the auditor to attest to and report on the assessment made by the management of the said internal control structure. This will be additional work for the auditors who already are under pressure to be more vigilant in their performance of the audits. Therefore, it is expected that due to the increased demand for diligence in their work, and because of the need for the compliance with Section 404 of SOX, audit fees will soar with each year (Scott 2003, Cohen and Vecchio, 2004).

Based on this background, we asked the following three research questions in this study:

- (1) Would the imminent decrease in the “non-audit service fee” component of the total fees, caused directly by section 201 and indirectly by section 202 of SOX, result in the auditor firms making up for the lost “non-audit service revenues” by trying to gain more “audit-based revenues”?
- (2) Would the increased work on the part of the auditors as required by section 404 of SOX potentially raise the audit fees component of the total fees?
- (3) The Big 4 CPA firms audit more than ninety-seven percent of the large publicly traded companies (USGAO, 2003). Therefore, following the above two questions, since three of these Big 4 CPA firms already have spun off their consulting activities, would these CPA firms undergo major changes as to their market share among the major types of services, viz., audit services, audit-related services, tax-related services, and other services?

The results of our research showed that the total amount of non-audit service fees expressed as a percentage of the total compensation received by the four CPA firms dropped by more than 50% from FY 2001 to FY 2004, while the total amount of audit fees as a percentage of total auditor compensation received increased by 270% during this period. Besides, there was a noticeable *redistribution* of how each of the Big 4 CPA firms received its revenues from the sampled companies. The redistribution happened both with respect to each firm’s relative share out of the aggregate fees paid by the entire sample for each type of service, and how much of each firm’s own revenue was received from each of the four major types of services.

² The list of prohibited services is located at <http://news.findlaw.com/hdocs/docs/gwbush/sarbaneSOXley072302.pdf>.

PURPOSE OF THIS STUDY

In order to investigate this likely effect of SOX, the current study examined the changes in the *pattern* of the compensation received by the Big 4 CPA firms from some of the publicly traded U.S. companies, both before and after the implementation of SOX. Specifically, the study examined the amount of audit and non-audit service fees paid by a sample of publicly traded companies with reported revenues exceeding \$10 billion for the fiscal years 2001 and 2004. We only considered audit clients with reported revenues exceeding \$10 billion because such companies are likely to incur relatively larger amount of auditor compensation payments due to the volume of work involved. This would make it imperative for their auditors to be cautious in their relationship with these clients, and motivate them to keep an appearance of complete *independence* especially in connection with the provision of audit and non-audit services. The sample of companies was restricted to those audited by the Big 4 CPA firms, because in the audit market for publicly traded companies, these four firms currently audit over seventy-eight percent of all U.S. public companies, ninety-seven percent of all U.S. public companies with sales exceeding \$250 million, and ninety-nine percent of all public company sales (USGAO, 2003). Thus, we anticipated that any redistribution of the compensation would have to occur primarily among these four CPA firms.

The purpose was to determine the extent and nature of change, if any, in the relative amount and pattern of compensation received by these four accounting firms, both before and after the passage of SOX. We expected that pursuant to the prohibition imposed by SOX on the supply of certain non-audit services by the auditors to their audit clients, there would be a large downward shift in the total compensation received by these four CPA firms from the non-audit services. The decrease in the supply of non-audit services by these CPA firms also could be because of a perceived need to improve the appearance of their own independence from their audit clients. Further, we also expected a large upward shift for audit fees earned by the four CPA firms, both taken together and individually. Finally, we examined if the shifts in the pattern of compensation were uniform across the four CPA firms. In the following sections, we describe the collection of data and findings of the analysis.

COLLECTION OF DATA AND DESCRIPTION OF THE SAMPLE

The data for this study were obtained from the proxy statements of one hundred and thirty-two (132) companies listed on the major stock exchanges in the United States. The initial sample was generated randomly from the LEXIS/NEXIS Database of *Company Financial Reports* and included two hundred (200) companies with reported revenues exceeding \$10 billion for the fiscal year 2004. These companies were screened further by examining their reported revenues for the fiscal year 2001. The resulting sample included one hundred and sixty-five (165) companies, all of which were audited by one of the Big 4 CPA firms and each with reported revenues of more than \$10 billion for FY 2001 and FY 2004. However, we eliminated thirty-three (33) companies that were audited by Arthur Andersen, LLP, in 2001 so that the final sample consisted of one hundred and thirty two (132) public companies that were audited by the same set of Big 4 CPA firms in both years under study. The reason we chose 2001 and 2004 as the years of study was that the year 2001 marked the beginning of the outburst of corporate scandals that subsequently resulted in the passage of SOX, while the year 2004 was the first calendar year after the SEC and the leading stock exchanges made rules to comply with the requirements of SOX. This facilitated our study of the similarities and differences, if any, between the compositions of the auditor compensation received by the Big 4 firms during these two milestone years. For the purpose of the study, we considered auditor compensation as consisting of four components: audit fees, audit-related fees, tax-related fees and fees for *other services* (or other fees), where we considered the last three as “non-audit service fees components”. Audit-related fees typically are for services that are *reasonably related* to the performance of the audit or review of the financial statements and may include fees for matters related to the business acquisition and divestitures, independent assessment of controls related to outsourcing services, and review of a company’s retirement and other benefit-related programs³.

³ This is based on a review of the information given in the proxy statements.

Only thirteen (13) companies in the sample were traded on the National Association of Security Dealers' Automated Quotation System (NASDAQ) or the Over-the-Counter Market while the remaining one hundred and nineteen (119) firms were listed on the New York Stock Exchange (NYSE). For each of these sampled companies, we accessed the relevant proxy statements and examined the disclosures regarding the auditor compensation paid during the fiscal years 2001 and 2004, respectively. Each proxy statement provided details of the auditor compensation including the specific amounts paid for audit work, audit-related services, tax-related services, and *other services* such as consulting services⁴. Table 1 below shows the distribution of the companies among the Big 4 CPA firms in 2001 and 2004. While the number of sampled companies audited by each of the Big 4 CPA firms remained little changed, there were a few cases of auditor switching among these four firms between 2001 and 2004.

Table 1
Summary of Descriptive Statistics for the 132 Sampled Companies

	Deloitte and Touche	Ernst and Young	KPMG	PricewaterhouseCoopers
No. of sampled companies handled in 2001	32	36	20	44
Total Fees (\$) received from the sampled companies in 2001	\$569,183,482	\$411,670,299	\$370,213,130	\$1,480,190,014
No. of sampled companies handled in 2004	32	36	22	42
Total Fees (\$) received from the sampled companies in 2004	\$642,658,977	\$454,591,117	\$444,235,234	\$1,065,716,641

DATA ANALYSIS AND DISCUSSION OF FINDINGS

Comparing across the two years, 2001 and 2004 (pre- and post-SOX), we noted that the overall non-audit services fees paid by the sample dropped significantly from seventy-three percent of the total auditor compensation in 2001 to thirty-three percent in 2004. Consequently, the audit fees component increased dramatically from twenty-seven percent of the total auditor compensation in 2001 to sixty-seven percent in 2004. Among the non-audit service fees, over the same years, the percentage of amount paid for *other services* including *FISDI services* and other miscellaneous services dropped from forty-four percent in 2001 to two percent in 2004 in relation to the aggregate auditor compensation paid by the sample. Table 2 shows a quick comparison between the different components of auditor compensation during the fiscal years 2001 and 2004. The complete drop in the *FISDI* fees and other miscellaneous service fees was not surprising especially in the light of the prohibition on the provision of these services by CPA firms to their audit clients pursuant to SOX.

⁴ In some cases, the companies did not clearly provide the details of tax-related or audit-related fees but instead combined them under the heading “all other fees” since the original SEC rules did not require details of fees paid under each type of service.

Table 2
Breakdown of Auditor Compensation Paid during 2001 and 2004
by 132 Public Companies with Revenues Exceeding \$10 Billion

Type of Service Provided by the Auditor Firms	Percent of Aggregate Auditor Compensation during 2001	Percent of Aggregate Auditor Compensation during 2004
Audit Fees	27%	67%
Non-Audit Fees	73%	33%
Non-Audit Fees consisted of		
Audit-Related Fees	14%	12%
Tax-Related Fees	15%	19%
Other/Miscellaneous Fees	<u>44%</u>	<u>2%</u>
Total	73%	33%

The percentage of total fees paid for “audit-related matters” declined from fourteen percent to twelve percent (i.e., a decline of fourteen percent over the 2001 amount). In contrast to the other two “non-audit service fees components”, the percentage of total auditor compensation paid for tax-related matters increased from fifteen percent in FY 2001 to nineteen percent in FY 2004, an increase of twenty-five percent over the three years; however, the reason for this increase is unclear from the information given in the proxy statements. In the absence of sufficient public information, it is not known if the companies in the sample may have re-bundled some of their *other fees* as tax-related fees.

Big 4 CPA firm-specific observations

In the post-SOX period, there was a redistribution of the revenues among the Big 4 CPA firms as is evident from the information summarized in Table 3 below. While PWC had the largest share (52%) of FY 2001 aggregate auditor remuneration paid by the sampled companies, its share of this aggregate remuneration dropped by eleven percent by the end of FY 2004. The share of the market lost by PWC in FY 2004 was gained by the other three CPA firms, namely, D&T, E&Y and KPMG. The biggest gain in market share was made by D&T who increased its share by four and a half percent. KPMG and E&Y increased their shares by four percent and approximately three percent, respectively. Table 3 also shows that in the year 2004, there was a change in how each of the Big 4 CPA firms earned its revenues from the companies in the sample. The audit compensation pattern of the Big 4 firms shifted in different directions, depending on the type of service involved.

Table 3
Distribution of Auditor Compensation from the Four Components of Revenues
among the Big 4 CPA Firms

2001	Audit Fees	Audit-related Fees	Tax-related Fees	Other Fees	Total for each firm	Across Firms
Deloitte & Touche, LLP	193,031,610	56,674,190	62,859,060	256,618,622	569,183,482	20.1%
% of total for the firm	33.9%	10.0%	11.0%	45.1%	100.0%	
Ernst & Young, LLP	113,611,680	112,276,119	91,899,106	93,883,394	411,670,299	14.5%
% of total for the firm	27.6%	27.3%	22.3%	22.8%	100.0%	
KPMG, LLP	114,697,760	43,764,230	96,197,000	115,554,140	370,213,130	13.1%
% of total for the firm	31.0%	11.8%	26.0%	31.2%	100.0%	
PricewaterhouseCoopers, LLP	335,218,853	174,320,750	171,351,371	799,299,040	1,480,190,014	52.3%
% of total for the firm	22.6%	11.8%	11.6%	54.0%	100.0%	
2004	Audit Fees	Audit-related Fees	Tax-related Fees	Other Fees	Total for each firm	Across Firms
Deloitte & Touche, LLP	443,841,928	65,269,430	95,677,027	37,870,592	642,658,977	24.6%
% of total for the firm	69.1%	10.2%	14.9%	5.9%	100.0%	
Ernst & Young, LLP	312,793,620	42,779,708	92,019,389	6,998,400	454,591,117	17.4%
% of total for the firm	68.8%	9.4%	20.2%	1.5%	100.0%	
KPMG, LLP	309,505,840	61,074,707	66,306,551	7,348,136	444,235,234	17.0%
% of total for the firm	69.7%	13.7%	14.9%	1.7%	100.0%	
PricewaterhouseCoopers, LLP	688,512,889	134,257,674	230,504,498	12,441,580	1,065,716,641	41.0%
% of total for the firm	64.6%	12.6%	21.6%	1.2%	100.0%	

In FY 2001, among the four firms, PWC led the way by earning fifty-four percent of its revenues from “other services”, followed by D&T, KPMG and E&Y that earned forty-five percent, thirty-one percent and twenty-three percent, respectively. However, in FY 2004, D&T topped the list by earning almost six percent of its total revenues from “other services” while the other three earned less than two percent each, PWC being at the end of the list with only a little more than one percent of its revenue derived from “other services.”

Also in FY 2001, KPMG (26%) and E&Y (23%) received proportionately more of their total revenues from tax-related services followed by PWC (12%) and D&T (11%). In FY 2004, E&Y (20%) saw a small decline in its reliance on tax-related service fees while KPMG (15%) experienced a significant decline in its proportionate revenues from the same. Whereas D&T (15%) saw a moderate thirty-five percent increase in its tax-related revenues in FY 2004 compared to that in FY 2001, PWC (22%) enjoyed almost ninety percent jump in its tax-related service fees between the two years. Further, E&Y was the only firm that faced a sixty-five percent decline in its proportionate revenue from audit-related services by earning only nine percent of its total compensation from such services in FY 2004, as against twenty-seven percent in FY 2001. D&T experienced little change in this area of its revenue while the other two firms experienced modest increases in their revenues from audit-related fees.

All four firms increased their reliance on audit fees as the main source of revenue in FY 2004 when compared to that in FY 2001. Among the four firms, KPMG had the largest percentage (70%) of its revenue derived from the audit fees in 2004 while PWC had the smallest such percentage (65%). Yet, PWC enjoyed the largest increase in its proportionate revenue from the audit fees in FY 2004 wherein its audit fee revenue jumped

by nearly 200% compared to that in FY 2001. In addition, D&T had the second largest percentage (69%) of revenues coming from audit fees in FY 2004, which was an increase of more than 100% over its audit fee revenue in FY 2001. Both KPMG and E & Y saw their audit fees grow by much more than one hundred percent from FY 2001 to FY 2004.

An interesting observation to note here is that in FY 2001, each of the Big 4 CPA firms relied relatively differently on the four components of its compensation. D&T and PWC depended on audit fees and *other fees* to make up for nearly eighty percent of their total revenues, with PWC depending much more on *other fees* compared D&T. KPMG earned a little more than sixty percent of its revenues from audit fees and *other fees* and relied more on the tax-related fees than its three competitors did. E&Y however derived almost equal amount of its revenues from all four components, with relatively more emphasis on the audit fees and audit-related fees. In fact, E&Y was the only firm that depended least on *other fees* in FY 2001. However, this picture changed in FY 2004 where all four CPA firms received more than sixty percent of their compensation from audit fees, perhaps due to such reasons mentioned earlier as the mandatory drop in consulting fees and the increase in the auditing requirements required by SOX.

CONCLUDING REMARKS

Based on the analysis of the data, we conclude that after the passage of SOX, the companies in the sample as a group are paying less for the non-audit services performed by their auditors, which may help improve the appearance of independence of their auditors. Whereas in FY 2001, the non-audit services consisted of FISDI and other technology-related consulting services, the typical non-audit services purchased in FY 2004 primarily have consisted of audit-related and tax-related services. It is not clear as to how much of the decrease in non-audit service fees is because of a definite action taken by the companies themselves and how much is due to the reluctance on the part of the auditors to perform such services for their clients because of the stringent requirements imposed by sections 201 and 202 of SOX.

Concurrently, there is a noticeable redistribution of how the Big 4 CPA firms earn their revenues, at least with reference to the compensation received from the sampled companies. Whereas in the pre-SOX period (2001), PWC had more than fifty percent of the market share in the sample, in the post-SOX period (2004), PWC's share reduced to nearly forty percent of such market. Each of the other three Big 4 CPA firms has increased its own share of the market in FY 2004. Further, in FY 2001, each of the four firms derived its revenues from these clients by relying in different proportions on the different components of its remuneration. However, in the post-SOX period (2004), all four firms derived the major portion of their revenues from audit fees, followed by tax-related services, with very little dependence on "other services." Once again, the Big 4 CPA firms appear to have become the providers of "audit and assurance services" and less of "consulting firms", which befits their title! While this will increase the demand for accounting graduates with skills in the area of auditing, it may also trigger renewed competition among the *Big 4* for both audit clients and accounting talent.

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SECTION II.

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PAPER #: CS-4.1.2

TITLE: *Implementation of International Financial Reporting Standards in Gulf Countries and Accounting Quality*

AUTHORS:

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ABSTRACT:

Success in implementing the right International Financial Reporting Standards in the Gulf countries, as in many European Union listed companies, depends on to what extent and how quick will listed firms in the Gulf countries are responding to the global financial community convergence. This paper examines determinants and effects of environmental factors on accounting differences and similarities between Local Accounting Standards of the Gulf countries and International Accounting Standards issued and revised by the IASB. First; some of the environmental variables, which are unique for Gulf countries and may have effect on the development of accounting and auditing standards, will be analyzed. Then, similarities and differences of key accounting issues will be discussed. Finally, general guidelines and major recommendations on the implementation of IFRS, to help investors and creditors in making their strategic investing and financing decisions in the Gulf countries will be presented.

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PAPER #: CS-2.1.2

TITLE: *Does Audit Committee Independence Improve Information Content of Earnings under the Sarbanes-Oxley Act?*

AUTHORS:

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ABSTRACT:

We examine the relationship between information content of earnings and disclosure of audit committee independence under the Sarbanes-Oxley Act (SOX) and the Security Exchange Commission (SEC) rules. Specifically, we are interested in the difference in information content of earnings between U.S. and non-U.S. firms due to the fact that non-U.S. firms were not required to comply the audit committee independence requirements while most U.S. firm already complied in 2002. Using 82 non-US firms and 82 matched U.S. firms from the New York Security Exchange (NYSE), we find evidence that the U.S. firms have higher information content of earnings than the non-U.S. firm in the year of 2002. The information content of earnings is found to be positively related to the board and audit committee independence. For non-U.S. firms, we also find that early compliance of audit committee independence requirement is favorably recognized by the market. Our findings provide evidence that disclosures of audit committee independence and other corporate governance structure under the requirements of the SOX as well as the SEC rules actually improve information content of earnings.

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PAPER #: CS-1.1.1

TITLE: *A Guide to Venue Rules in Federal Tax Disputes*

AUTHORS:

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ABSTRACT:

Taxpayers are permitted to raise tax disputes in several forums, both judicial and administrative. Venue rules play an integral role not only in gaining access to these forums, but also in determining the legal precedents that will be applied by a reviewing official. The interaction of these venue rules and the mobility of the individual taxpayer provide opportunities to “forum shop.” These opportunities, however, are less prevalent for corporate taxpayers due to the obvious difficulty in easily changing the corporation’s “principal office or principal place of business.” This article presents a “one-stop shop” analytical guide to these diverse venue rules, starting with the initial filing of a tax return or refund claim and culminating with the filing of an appeal with a United States Court of Appeals. Particular attention is paid to the choice of law issues that arise from intercircuit conflicts in the United States Courts of Appeals.

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PAPER #: CS-2.4.1

TITLE: *Using Design Patterns, Analysis Patterns and Case-Based Reasoning to Improve Information Modeling and Method Engineering in Systems Development*

AUTHORS:

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Central Connecticut State University

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ABSTRACT:

Information modeling (IM) is the process of identifying information needs and models based on user requirements and systems analysts' perceptions during systems analysis and design. When IM is done correctly, it facilitates communication between the analysts and end-users about the final software product. In addition, successful IM provides a formal basis for both the analysts and the end-users about the tools and techniques that will be used in software development (SD), which, in turn, reduces costly overruns in time and money during systems implementation. Method engineering (ME) is the process of designing, constructing, and adapting information modeling methods for information systems development. As Siau (2003) and Kavakli (2005) point out that, while there has been a steady increase in IM and ME research (e.g. Kawalek & Wastell 2003, Kavakli 2005, Matulevicius 2005), most of the models reported in recent literature are still primarily based on common sense approach, and, as a result, lack a solid theoretical foundation. This paper discusses the feasibility of combining design patterns (DPs), analysis patterns (APs) and case-based reasoning (CBR) to improve information modeling and method engineering. Recent research in DP, AP, and CBR has proven that all those methods are effective in software development. In this paper, we propose a model that combines DP, AP and CBR as a tool to improve IM and ME. We believe that the use of DP and AP, along with CBR will facilitate easier communication among systems analysts, end-users and software engineers thus improve on the efficiency in software development. In the paper, we also provide illustrative examples from accounting systems design to show the effectiveness of our proposed model. Finally, we provide evidence in this paper that the practical application of DPs, APs and CBR to systems development makes it possible to identify and resolve critical issues and risks at earlier stages in IM and ME, and eventually lead to high quality end product.

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PAPER #: CS-3.2.2

TITLE: *Fair-Value Option - A New Accounting Concept as Risk Management Tool*

AUTHORS:

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ABSTRACT:

As the financial servicing market becomes more and more active and innovative, new financial products are being introduced faster than the accounting standards can ever address. Statement of Financial Accounting Standard (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, issued in September 2000, established the "financial component approach" that basically allows the market to create/identify financial components and to account for them with the fair value. However, the complications of newly identified financial components (assets) soon outgrow the guidelines given in SFAS No. 140. In August 2005, the FASB issued three Exposure Drafts to amend or to totally replace SFAS No. 140. A brand new accounting concept introduced in one of the three Exposure Drafts is the "Fair-Value Option" where companies are allowed a one-time, irrevocable option to account for their financial asset servicing rights with either the fair value or the current lower of cost or market (LOCOM) method. This article discusses the fair value option: the background, the needs that call for such an option, and the potential impacts on the reporting of financial assets. A side-by-side comparison of the current standard and the proposed treatments is also provided.

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PAPER #: CS-1.4.3

TITLE: *The Impact of the Sarbanes-Oxley Act of 2002 on the Value Relevance of Auditor's Fees*

AUTHORS:

Seong Yeon Cho
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Kevin F. Brown
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ABSTRACT:

In the wake of the Enron and WorldCom accounting scandals, nonaudit services provided by auditors have come under the scrutiny of Congress as reflected in the Sarbanes-Oxley Act of 2002. In an attempt to better understand the impact of the Act, this study sets forth two specific objectives. The first objective is to examine the value relevance of auditor's fees. The other objective is to investigate which components of the fees, if any, are important in the determination of firm values. We find that nonaudit fees have a positive association with firm values, which suggests that investors perceive nonaudit services as value increasing services. Among the components of auditor's fees, audit related fees and tax fees have significant positive relationships with firm values. These results are contrary to the prevailing belief that nonaudit services impair auditor independence. However, in additional analysis, we find that investors' perception of nonaudit fees has changed. In particular, investors react more favorably to an increase in nonaudit service fees after SOX while they did not have such a reaction prior to SOX.

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PAPER #: CS-2.1.3

TITLE: *Use of Tax based Abnormal Accruals in Detecting Earnings Management beyond Managing Book-tax Difference*

AUTHORS:

Seong Yeon Cho
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ABSTRACT:

This paper examines the usefulness of tax based abnormal accruals in detecting earnings management compared to deferred tax expense. This paper explores how the usefulness of tax based abnormal accrual and the deferred tax expense are influenced in detecting earnings management when benefits of increasing taxable income are present or the benefits exceed the expected increase in tax payables. In particular, this study examines how the unused loss carryforward, book-tax conformity, or seasoned equity offering, where there is strong incentives to manage earnings regardless of tax consequences, affects the usefulness of deferred tax expense, and tax based abnormal accrual measure in detecting earnings management. This study finds that the firm's incentive to manage taxable income impairs the usefulness of deferred tax expense in detecting earnings management while it doesn't tax based abnormal accruals.

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PAPER #: CS-1.5.1

TITLE: *Accounting for War*

AUTHORS:

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ABSTRACT:

This paper examines the ways in which accounting has helped to rationalize and normalize violence and how this has contributed to the acceleration and expansion of war. It is argued that accounting is a product of the "social imaginary" of modernity which projects a brutal attitude towards others by instrumentalizing relationships. Accounting's reliance on instrumental rationality and economic efficiency provides the ideological justification for destroying the environment and others. Accounting's role in perpetrating war and warlike behaviors is demonstrated in relation to our war with the environment, the expansionistic logic of capitalism, dehumanization and distance, globalization, the silent war of economic sanctions and the extent to which war is good for business.

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PAPER #: CS-1.1.3

TITLE: *The Effect of Changes in the Value of the Tax Timing Option and Overall Market Conditions on the Market Response to Large and Small Stock Distributions*

AUTHORS:

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ABSTRACT:

A widely cited finding from Grinblatt et al. (1984) (GMT) is that the market response to the announcement of stock distributions is greater for small distributions than for large ones. However, the GMT result does not hold in all time periods. Two macroeconomic effects, changes in the tax law and the 1982-2000 bull market may explain the presence of the GMT result in some time periods and the absence of it in others. The tax law changes affected the value of investors' tax timing options, and therefore the value of stock distributions. The bull market affected the value and credibility of signals from management. Both effects changed the association between the size of the distribution and the pre-distribution share price and between the pre-distribution price and the market's response to the distribution. These changes altered the GMT result, which is the association between the distribution's size and the market response.

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PAPER #: CS-1.3.1

TITLE: *Disclosure and Auditor Choice by Foreign Registrants in the United States*

AUTHORS:

Edward B. Douthett, Jr.
George Mason University

Jonathan E. Duchac
Wake Forest University

ABSTRACT:

In this study we examine the relation between disclosure and auditor choice by foreign companies listing securities on a U.S. stock exchange. We find that the choice of an industry-specialist auditor is positively associated with a higher level of disclosure, and simultaneously, the level of disclosure is a positively associated with the choice of auditor quality. We infer from these results that auditor choice, in conjunction with disclosure choices, reflects the underlying disclosure strategy of management, and is not solely a decision to improve disclosure quality. Corporate management has a propensity towards a certain level of disclosure quality and not only chooses an auditor to improve disclosure, but also chooses an auditor with expertise and knowledge that is commensurate with the desired level of disclosure quality.

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PAPER #: CS-2.2.1

TITLE: *The Influence of Audit Structure and Accounting/Auditing Knowledge on Judgments of Audit Quality and Auditor Liability*

AUTHOR:

Linda Flaming
Monmouth University

ABSTRACT:

Audit quality and auditor liability have come under increasing scrutiny in the time period preceding and following the enactment of the Sarbanes Oxley Act. Preconceived perceptions of the accounting profession may affect juror decisions in auditor litigation settings. This paper looks at how two factors, awareness of audit structure and knowledge about accounting and auditing procedures may affect juror decisions about audit quality and auditor liability when investors bring suit against an auditor for failing to uncover material misstatements in their audit. Identification and description of audit structure did not affect juror audit quality and auditor liability assessments, but undergraduate auditing students judged audit quality to be higher and auditor liability to be lower than students beginning their first accounting course.

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PAPER #: CS-1.3.2

TITLE: *Financial Analysts' Forecasts and Unprecedented Events: The Case of German Reunification*

AUTHORS:

WaQar I. Ghani
Saint Joseph's University

Samuel H. Szewczyk
Drexel University

Tayyeb Shabbir
University of Pennsylvania

ABSTRACT:

We use the chain of events from the fall of the Berlin Wall to the reunification of Germany to examine how capital market participants respond to momentous and unprecedented events. Our examination measures the impact of these events on analysts' forecasts for the earnings of West German firms. Our results show a significant decrease in analysts' ability to accurately forecast earnings. Contrary to the public's euphoria, the sense of the market was generally negative about the implications of unification for West German firms. This negative sentiment was spread across most of the broad sectors, but within those sectors the results were significantly positive for select groups of industries.

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PAPER #: CS-2.5.3

TITLE: *Take One Part at a Time and Pass Both the CPA and CMA Exams Within Nine Months After Graduation: A 10 Step Streamlined Approach*

AUTHORS:

Joe Hargadon
Widener University

Lori Fuller
Widener University

ABSTRACT:

Accounting educators have long recommended that students pursue professional accounting certification. Although the Certified Public Accountant (CPA) designation has likely been the “marquee” credential for accountants, the Certified Management Accountant (CMA) is gaining in recognition and stature. To increase their marketability and career options, accounting students should consider pursuing dual certification. In a survey of members of the Institute of Management Accountants, Schroeder and Reichardt (2005) reported that individuals, who hold the CPA and/or CMA designation, earn more, on average, than their non-certified counterparts. Respondents to this survey who held both the CPA and CMA credential reported greater average salary figures than those holding only one of these certifications. In this paper we outline a ten-step program that faculty can recommend to their undergraduate accounting students to efficiently approach their preparation for both exams. We assume a “typical” undergraduate accounting program. If followed, candidates would start their preparation in their junior year, spread out their preparation over a reasonable time period by taking only one part at a time, reduce the overall number of parts required to be taken from 8 to 7 and complete both exams within nine months of completing their undergraduate degree.

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PAPER #: CS-3.3.1

TITLE: *Does Functional Experience Impair the "Balance" in Balanced Scorecards?*

AUTHORS:

M. Elizabeth Haywood
Rider University

Nathan V. Stuart
University of South Florida

ABSTRACT:

In this paper, we examine the effect functional experience and other individual characteristics have on how managers consider and use balanced scorecard information. Using Upper Echelons Theory, we predict that a manager's functional experience will be associated with his or her information acquisition use and final choice in an investment decision. We test our hypotheses using a laboratory experiment in which subjects make a capital investment decision from a menu of available opportunities. We do not detect an association between individual characteristics and information acquisition behavior but we do detect an association between individual characteristics and investment choice. We discuss how our findings help resolve the discrepancies in previous studies and suggest implications for companies that use the balanced scorecard.

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PAPER #: CS-2.3.1

TITLE: *Initiatives to Reform Financial Management in the U.S. Federal Government: A Review*

AUTHORS:

Byron Henry
Howard University

ABSTRACT:

No abstract available at this time

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PAPER #: CS-3.2.1

TITLE: *Measures of Risk in Performance Pricing-Based Debt Contracts and Firms' Reporting Behavior*

AUTHORS:

Peter Hostak
University of Massachusetts Dartmouth

ABSTRACT:

This study explores the impact of credit risk measures defined in the performance pricing debt contracts on the reporting behavior of firms. I begin by examining the distribution of debt-to-EBITDA ratios of firms with debt contracts that contain debt-to-EBITDA pricing provisions to investigate whether firms manage reported ratios around the thresholds defined in the debt contracts. The observed discontinuity in this distribution suggests that firms use discretion to report financial ratios that fall "just below" these thresholds. Next I analyze factors that proxy for the costs and benefits of discretionary reporting. This analysis indicates that the propensity to report a debt-to-EBITDA ratio that falls "just below" the defined threshold increases in both the economic significance of the contract and the financial strength of the firm and decreases with the contractual constraints embedded in the debt contract. Finally, I document a negative change in the magnitude of discretionary accruals over periods following the debt contract date. These results identify previously unexplored sources of external demand for discretionary reporting and provide new insights regarding the trade-off between the costs and benefits associated with discretionary reporting choices.

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PAPER #: CS-2.4.3

TITLE: *A Study of the Demand for Information Technology Expertise: Evidence from the Appointment of Chief Information Officers*

AUTHOR:

Ashraf Khallaf
University of Southern Indiana

ABSTRACT:

The demand for information technology expertise has grown rapidly in last decade. This study explores factors determine a firm decision to hire chief information officers (CIOs) at the top management level during 1987-2002. Findings provide evidence that the demand for the chief information officer (CIO) position is driven by specific firm characteristics. A logistic regression model that considers CIO firms and their matched firms indicates that firms are more likely to hire a new CIO when they experience prior loss, large capital expenditures, and have a higher market value.

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PAPER #: CS-1.2.3

TITLE: *Short-term Profitability Consequences in Multinational Managerial Evaluations*

AUTHOR:

Lili-Anne Kihn
Montclair State University

ABSTRACT:

This study explores the impact of managerial evaluations upon short-term profitability and how the effect of the evaluations varies with perceived environmental changes. Using a sample of multinational manufacturing companies, the study investigates the impacts of headquarters' (HQs') emphasis of financial results controls, non-financial results controls and action accountability controls in foreign subsidiary manager performance evaluations. Documentary and survey data collected from 36 business units suggest that HQs' emphasis of financial results controls improves short-term profitability more so than does their emphasis of non-financial results controls, action accountability controls, or joint emphasis of multiple forms of controls. The results also indicate that the effects of emphasizing non-financial results controls on short-term profitability vary with perceived environmental changes.

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PAPER #: CS-4.2.3

TITLE: *The Effect of Enron on Credit Rating Agency Practices*

AUTHORS:

Myungsun (Sun) Kim
University at Buffalo

Carol Ann Frost
University at Buffalo

ABSTRACT:

This study examines the effects of the political process on credit rating agency (CRA) practices. We focus on the period following the high profile collapse of Enron, during which the large CRAs faced intense scrutiny by Congress and the Securities and Exchange Commission. We hypothesize that political pressure and the threat of new legislation created incentives for the large "nationally recognized" CRAs to become more timely (either in fact or in appearance) in predicting default. We find strong evidence supporting our hypothesis. We then investigate competing explanations for the observed change.

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PAPER #: CS-1.2.2

TITLE: *Absorption Costing and Variable Costing Income Differences: Exceptions to the General Expectations*

AUTHOR:

J. William King
Washington and Lee University

ABSTRACT:

Although it is always true that the difference between absorption costing income and variable costing income is equal to the change in fixed cost in inventories, it is not always true that changes in inventory unit levels and changes in the fixed cost in inventory are positively correlated. The relationship between inventory levels and fixed cost in inventory also depends upon the inventory cost flow assumption and upon the direction and magnitude of any change in the fixed manufacturing overhead application rate in relation to the direction of the change in inventory units. After demonstrating the nature and extent of the exceptions, instructional resources are provided to assist instructors in integrating these concepts into their managerial accounting courses.

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PAPER #: CS-1.4.2

TITLE: *Audit Committee Financial Expertise, Litigation Risk and Corporate Governance*

AUTHORS:

Jagan Krishnan
Temple University

Jong Eun Lee
Temple University

ABSTRACT:

We examine the economic determinants of firms' choice of the "audit committee expert", for a sample of Fortune 1000 firms. Motivated by the new SEC disclosure rule for "audit committee financial experts", and recent market reaction studies relating to the appointment of financial experts to audit committees, we test the relation between the demand for audit committee experts with specialized accounting knowledge ("accounting financial experts"), potential litigation risk, and corporate governance. We find that firms with higher litigation risk are more likely to appoint accounting financial experts. Further, the association occurs for firms with relatively strong governance but not for those with weak governance. Our findings indicate that accounting financial expertise complements strong corporate governance, and that in good corporate governance situations, firms with higher litigation risk are more likely to appoint accounting financial experts to their audit committees.

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PAPER #: CS-3.1.3

TITLE: *Determinants of the Initial Corporate Costs to Comply With Section 404 of the Sarbanes-Oxley Act*

AUTHORS:

Jagan Krishnan
Temple University

Yinghong Zhang
Temple University

ABSTRACT:

This study examines companies' costs to comply with SOX Section 404 and identifies factors that are associated with these costs. Unlike prior work, we include both audit and non-audit compliance costs. In particular, section 404 costs can be classified into three categories: internal labor costs, external consulting and technology expenses, and auditor attestation charges. Based on a sample of companies that voluntarily disclosed SOX 404 cost information during the period from January 2003 to September 2005, we find that the mean total compliance costs for Section 404 is \$2 million. Multivariate analyses indicate that the compliance costs are positively associated with the incidence of material internal control weaknesses, business complexity, and firm risk, and negatively associated with firm membership in regulated and litigation risk industries.

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PAPER #: CS-2.5.2

TITLE: *Customer Turned Consultant: Developing a Balanced Scorecard for the Campus Bookstore*

AUTHORS:

Andrew Lafond
Philadelphia University

Anthony H. Catanach
Villanova University

Noah P. Barsky
Villanova University

ABSTRACT:

This case provides management accounting instructors a practical and efficient way to employ experiential learning in teaching the Balanced Scorecard. The case specifically requires students to visit their university campus bookstore, meet with store managers, and develop a Balanced Scorecard for the enterprise. Students gain a valuable applied learning experience by simulating a consulting engagement when they research the store's operations and industry trends, consider their own personal customer experiences, interview employees, and prepare a written report for store management. The case requirements address many of the analytical, communication, and experiential competencies suggested in widely-discussed calls for accounting education change. This case offers broad appeal to instructors and students at institutions of all types as the on-campus bookstore provides a practical, safe, and convenient opportunity for students to visit a real retail business that is extremely familiar to them. The authors have utilized this case at the undergraduate and graduate levels with very favorable responses from students and bookstore employees.

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PAPER #: CS-1.3.3

TITLE: *The Impact of US GAAP Reconciliations of American Depository Receipts on Security Analysts' Forecasts*

AUTHOR:

Christopher Luchs
Marshall University

ABSTRACT:

Recently, studies have examined the role of analysts in the examination of the US generally accepted accounting principles (GAAP) reconciliation information of American Depository Receipts (ADRs). Karamanou and Raedy (2001) examine analysts' forecast revisions for ADRs. The results show that US analysts use the US GAAP reconciliation contained in Form 20-F. Hora (1999) examines the volume of analysts' forecasts revisions and finds that analysts tend to revise their forecasts around the filing of Form 20-F with the Securities & Exchange Commission (SEC). However, these studies do not examine the association between the US GAAP reconciliation items in Form 20-F and analysts' behavior. The purpose of this study is to examine the association between US GAAP reconciliation and analysts' forecasts and forecast errors. The results show that analysts use the information in the lagged reconciliation items in developing forecasts for US GAAP-based earnings. In addition, the results indicate that analysts may not fully understand the implications of the reconciliation items in developing their forecasts. Since financial analysts provide major information content to security markets, this study may help resolve the debate between the SEC and the NYSE concerning the requirement of non-US firms to provide US GAAP reconciliation.

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PAPER #: CS-1.2.1

TITLE: *The Role of Organizational Culture, Budget and Trust in Managing Sales Outlets in Asia*

AUTHORS:

Sakthi Mahenthiran
Butler University

Zalina Hashim
University Institute of Technology Mara

ABSTRACT:

This is an empirical study of the relations between organizational culture, supervisors' budgetary style, subordinates' autonomy, the level of trust between supervisor-subordinate and how they affect sales growth. Given these variables important to the success of restructuring following privatization, we develop five hypotheses in a conceptual framework. They are tested using survey data from 148 respondents from telecommunication and electric companies in an Asian country. We find that culture affects subordinate's autonomy and budgetary style affects the supervisor's trust in subordinates. Further, trust congruence influences subordinate's autonomy that interacts with outlet's importance to affect sales growth. The results suggest that adjustment to structure and evaluation systems have to be made so that supervisors will adapt a profit conscious budgetary style and subordinates value greater autonomy.

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PAPER #: CS-2.3.3

TITLE: *Reciprocity and Financial Information Relevance*

AUTHORS:

Evelyn McDowell
Rider University

ABSTRACT:

The goal of this study is to provide direct evidence of the relationship between donations, reciprocity, and the use of financial information by donors. An underlying assumption in accounting research is that donors are swayed by financial information. However, there is little direct evidence. This study provides data on how donors actually use financial information in their decision process. A pre-decisional research method is used to track the information selected by subjects. The findings indicate that reciprocity is a powerful motivator. The program ratio, a supposedly salient piece of financial information and purported to play a significant role in donor's investment choice, is not the overwhelming factor in the decision to contribute to an organization. Additionally, the evidence support that non-financial information is useful and, in some cases, makes accounting information less relevant. Overall, the findings indicate that reciprocity affects donor decision making and the use of financial information.

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PAPER #: CS-1.5.2

TITLE: *From 1896 to 1905, the First Ten Years of the New York State Board of Examiners of Public Accountants: Signaling to the Profession*

AUTHORS:

James J. McKinney
Howard University

George C. Romeo
Rowan University

ABSTRACT:

Professionalization can be viewed as a “process involving signals of movement towards occupational ascendancy.” An important signal in America's formulation and maintaining of accounting professionalization and jurisdictional claims was the passage in 1896 of the New York State CPA law and the establishment of the New York State Board of Examiners of Public Accountants (NYSBEPA). This jurisdictional legitimacy gave the statutory right as well as a monopoly for accountants to use the title Certified Public Accountant or the initials CPA in the state of New York. As the first state to pass a CPA law, New York established precedents for the guidance of the profession nationwide. Additionally, for the CPA profession to succeed and establish credibility as a viable profession, it was important for the newly established NYSBEPA to avoid any negative political influences and maintain perceptions of its integrity. The paper describes signaling by the NYSBEPA that occurred, demonstrating accounting professionalism and jurisdictional legitimacy to the public accounting and business communities of which some signals were precedent setting and others demonstrative of high ethical standards. In addition, this paper will examine the history and some of the accomplishments of the NYSBEPA and its leaders from 1896 to 1905.

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PAPER #: CS-1.4.1

TITLE: *The Association between Audit Firm-Client Relationship and Probability of Financial Statement Fraud*

AUTHORS:

Santanu Mitra
Montclair State University

Nashwa George
Montclair State University

Mahmud Hossain
University of Houston at Clear Lake

ABSTRACT:

The present study is an extension of auditor tenure literature investigating the effect of the auditor-client consecutive years of relationship on financial reporting quality. We perform multivariate cross-sectional regression analyses to examine the empirical relationship between five quantitative fraud indicators (used as proxies for potential fraud situation) and audit firm tenure (expressed in terms of number of years) in presence of several firm-specific variables. Using a sample of 709 firms, we find evidence of a negative relationship between four out of five financial fraud indicators and audit firm tenure. Consistent with prior studies (e.g., Carcello and Nagy, 2004; Myers, Myers and Omer, 2003; Johnson, Khurana and Reynolds, 2002), the results suggest that with increase in auditor-client relationship, the probability of financial statement fraud diminishes. The main result largely remains unchanged even after controlling for the effect of heavily represented industries in the sample. However, we observe that for a restricted sample of 561 firms where the auditor-client relationship is at least five years' old, the association between auditor tenure and financial statement fraud indicators is substantially moderated, and when industry effects are incorporated in the analyses, such association has become virtually non-existent. The overall result is consistent with the view that the financial statement fraud is most likely to occur in the initial years of auditor engagement. The longer audit firm tenure is associated with lower probability of fraudulent financial reporting. The study's results remain qualitatively identical in various specification tests.

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PAPER #: CS-2.4.2

TITLE: *Intelligent Management Information Systems: A Conceptual Design Framework for a System that Addresses the Problem of Too Much Data and Not Enough Information*

AUTHOR:

John J. Morris
Kent State University

ABSTRACT:

The problem of too much data and not enough information has increased over the past decade as corporations implement large scale enterprise resource planning systems with huge volumes of data, and the Internet exploded with even larger volumes of data. These two events have contributed to an environment that calls for a more intelligent approach to the process of scanning, screening, categorizing, storing, and presenting data to all levels of corporate management for decision support purposes. This paper proposes a conceptual design framework for an intelligent management information system that will fill this need. It draws on a wide variety of technology including: executive information systems, data warehousing, data mining, web based query engines, fuzzy logic, neural networks and other forms of artificial intelligence. It proposes to combine these technologies in ways that will greatly improve the speed, accuracy and usefulness of data being transformed into information.

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PAPER #: CS-3.1.2

TITLE: *Was Section 404 of the Sarbanes-Oxley Act of 2002 Necessary? Evidence from Accelerated Filers*

AUTHORS:

John J. Morris
Kent State University

ABSTRACT:

The Sarbanes-Oxley Act of 2002 has been the subject of considerable controversy in both the academic and practice communities, with many questioning whether the cost of compliance is worthwhile. Of particular interest has been Section 404 of the act, which requires companies to report on the effectiveness of their internal controls over financial reporting. This study examines a sample of accelerated filers that complied with Section 404 in their Form 10K annual reports between November 15, 2004 and January 31, 2005. It finds only weak evidence to support the hypothesis that various indicators of good corporate government are negatively associated with internal control weakness, and could therefore serve as proxies for Section 404 compliance. In most cases, there is no evidence of an association, which would be consistent with the argument that the Section 404 requirements of Sarbanes-Oxley were indeed necessary.

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PAPER #: CS-3.3.3

TITLE: *Keeping the Assets of Public Accounting Firms: How 'Bridgers' Are Affecting Turnover*

AUTHORS:

Hossein Nouri
The College of New Jersey

Steven Brody
State of New Jersey

ABSTRACT:

High turnover and its negative affects are major issues facing public accounting firms. As generation Y is starting to join public accounting, their life style and personality characteristics raise concerns of even greater turnover. The associated costs of recruiting, training, negative client relationships and loss of skilled human capital are therefore feared to be increasing. Utilizing data from surveys conducted by the Institute of Certified Public Accountants (AICPA) through years 1992-2005, the disparity of turnover between "bridgers" and "baby-bust" is examined. The findings suggest that "bridgers" who join public accounting firms may have different demographic characteristics than the general population. Evidence is also presented illustrating that the turnover rate among all public accounting firms have dropped over the years studied as "bridgers" have joined the workforce, contrary to expectation. Several explanations are offered for these unexpected results.

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PAPER #: CS-4.1.1

TITLE: *Corporate Governance in Thailand: What Has Been Done Since the 1997 Financial Crisis?*

AUTHORS:

Obeua S. Persons
Rider University

ABSTRACT:

The study finds that Thailand has taken many steps to improve its corporate governance including voluntary approaches such as best practice guidelines for board of directors and audit committees, and corporate governance rating; and mandatory approaches such as enhancing the rights of minority shareholders and creditors, increasing the board of directors' accountability, making accounting and auditing standards consistent with the internationally acceptable standards, and strengthening the enforcement of securities regulation. This study also provides suggestions for further improvement with respect to minority shareholder protection and education, the responsibilities of the BOD vs. the top management, the BOD structure of financial institutions, further amendments to the new Bankruptcy Act, the need for whistle-blower law, the valuation of certain assets, and the compliance with the Buddhist precepts. In addition, the Thai government needs to improve the check and balances of its own governance process and its "populist" policies. These findings and suggestions have direct implications for other developing countries which are attempting to improve their corporate governance.

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PAPER #: CS-2.5.4

TITLE: *Does a Classroom Physical Facility Affect Student Learning?*

AUTHOR:

Obeua S. Persons
Rider University

ABSTRACT:

This study is the first to statistically examine the relationship between a classroom physical facility and student learning measured by a course grade. The students are business majors in two sections of introductory managerial accounting course at a private university. Regression analysis, which controls for six variables, indicates that students are likely to achieve a better course grade if they are in a better classroom physical facility. This finding implies that professors and students should try to select a classroom with a better physical facility, and university administrators should allocate more resources to improve classroom physical facilities.

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PAPER #: CS-2.1.1

TITLE: *The Informativeness of Cash Flow Forecast Errors during the Regulation FD Environment*

AUTHORS:

Karin A. Petruska
Kent State University

ABSTRACT:

Prior literature suggests that analysts' forecasts serve as a proxy for investor beliefs. This paper addresses the accounting regime relating to whether cash flow per share forecasts add to the information content or disclosure of financial information and whether they provide value relevance. I specifically examine the time frame surrounding Regulation FD. I find support for prior research which indicates that Regulation FD is associated with analyst earnings per share forecast errors. By examining a sample of 286 firms, I provide evidence that suggests that analyst cash flow per share forecast errors provide incremental value in explaining analyst earnings per share forecast errors during this period. The empirical evidence also indicates that Regulation FD is positively associated with analysts' cash flow per share forecast errors after controlling for several determinants of earnings forecast, including earnings per share forecast error. To determine if an endogeneity issue exists between analyst cash flow per share forecast errors and analyst earnings per share forecast errors, I incorporate a set of simultaneous regression equations which lends support that both analyst cash flow per share forecast errors and analyst earnings per share forecast errors may be jointly determined.

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PAPER #: CS-4.3.2

TITLE: *Impact of Faith-Based Organizations' Organizational Factors and Financial Performance Measures on Funding Sources*

AUTHORS:

Kamala Raghavan
Robert Morris University

Lynne Lampkin
Robert Morris University

ABSTRACT:

This study examines the effect of organizational factors and financial performance measures on direct public support and government funding for faith-based organizations (FBO) in Pennsylvania and Ohio. Organizational factors such as size, age, and type of service, and financial performance measures such as expense, profitability, liquidity, and solvency ratios are gathered from the data on the IRS form 990. Prior research studies on the impact of the Charitable Choice provisions on FBO have focused on large organizations only; were mostly descriptive in nature; and focused on factors such as religious characteristics and effectiveness of programs. This study makes an important contribution to existing research by reviewing the relationships between organizational factors, financial performance measures and funding sources for FBO in the post Charitable Choice era. The results show that government funding is affected positively by age of the organization, and negatively by its size; and direct public support is affected negatively by debt ratio. Looking at the same relationships using a sample of social service organizations only, some interesting variations emerge. Direct public support is affected positively by fund raising expense, and negatively by days cash on hand; and government funding is affected positively by age and negatively by size. All of the above relationships were statistically significant. This study also examined the level of government funding over the study period, and found that the federal government's Charitable Choice provisions enacted in 1996 and the Office of Faith-Based and Community Initiatives established in 2001 have led to increased funding to FBO. Smaller FBO can use the results of the study to target the funding sources based on their own organizational and financial performance profile.

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PAPER #: CS-3.1.1

TITLE: *Auditor Switching After Andersen and SOX: An Oligopoly Model and Empirical Analysis*

AUTHORS:

Jason D. Schloetzer
University of Pittsburgh

ABSTRACT:

I analyze a Cournot model of oligopoly in order to predict the response of the audit services market to two exogenous events, 1) the merger between Arthur Andersen and the remaining Big N audit firms, and 2) the requirements of the Sarbanes-Oxley Act of 2002. The model predicts that the number of annual audits completed by the remaining Big N audit firms will decline after each event, creating increases in client switching from Big N auditors to non-Big N auditors. I present evidence supporting these predictions, while also documenting the noticeable change in the type of client that is switching to non-Big N auditors. In addition, I argue that the number of days between a client's fiscal year end and the submission date of its annual 10-K report to the SEC proxies for an auditor's private information regarding client audit risk. After controlling for financial risk, I find that as the 10-K reporting lag increases, the likelihood of switching from a Big N auditor to a non-Big N auditor increases. This result suggests that when choosing between clients of comparable financial risk, Big N auditors choose not to retain clients with higher audit risk.

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PAPER #: CS-4.1.3

TITLE: *The Value Relevance of Funds from Operations for REIT Investors*

AUTHORS:

Vincent Shea
Kent State University

ABSTRACT:

This paper examines the value relevance of net income and funds from operations (FFO) for REIT investors. Professional bodies, such as The National Association of Real Estate Investment Trusts (NAREIT) and Financial Accounting Standards Board (FASB), sharply differ in their preference for performance measurements specifically related to equity REITs. Whereas NAREIT advocates the FFO metric, the FASB states that the prominent use of FFO at the expense of GAAP net income may cause confusion for miscommunication to investors. Prior research in both the accounting and finance literatures has produced inconclusive results in this debate. This study adds to the literature by including more recent data over the period when real estate has received more attention by investors. The results of this study lend evidence that within the publicly traded equity REIT market, GAAP based earnings are a better predictor of abnormal returns than the arguably, more preferred FFO metric.

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PAPER #: CS-2.2.3

TITLE: *An Evaluation of the Construct Distinctiveness of Two Key Stress Measures Utilized by Behavioral Accounting Researchers.*

AUTHORS:

Kenneth J. Smith
Salisbury University

Jeanette A. Davy
Wright State University

George S. Everly, Jr.
Loyola College in Maryland

ABSTRACT:

This study measured the construct distinctiveness stress arousal and burnout as measured on the Stress Arousal Scale and the multidimensional role-specific version of the Maslach Burnout Inventory, respectively. Using scale data from 148 randomly selected public accounting professionals, we first constructed latent variables for the stress arousal and burnout factors. We then conducted confirmatory factor analysis on the scale data to determine whether the factors would load on their respective underlying theoretical constructs. Finally, we tested a nested model which constrained stress arousal and burnout to load on one underlying factor, against the hypothesized two-factor model. The results indicated good model fit for the two factor model and a significant loss of fit for the one-factor model, thus providing strong support for the conceptualization of stress arousal and burnout as distinct constructs.

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PAPER #: CS-2.5.1

TITLE: Teaching a Course on Computer Forensics and Fraud Examination

AUTHORS:

A. Blair Staley
Bloomsburg University of PA

Michael Shapeero
Bloomsburg University of PA

Scott Inch
Bloomsburg University of PA

ABSTRACT:

This paper presents a model for teaching a course on computer forensics and fraud examination. The use of various texts and software programs and other tools to transfer knowledge on computer forensics are discussed.

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PAPER #: CS-4.3.1

TITLE: *Cash to Accrual Accounting: One Nation's Dilemma*

AUTHORS:

Geoffrey A. Tickell
Monash University

ABSTRACT:

Over the past two decades, there has been a slow but steady global movement undertaken by most federal, state and local governments to move from cash-based accounting to accrual-based accounting. This migration from cash-based to accrual-based accounting is the result of calls for greater accountability and transparency in the public sector. It is anticipated that over the next few years, almost all countries will endeavour to alter their accounting systems and reporting practices to publish accrual accounting reports. Questions remain regarding the implementation of commercial accounting practices into public sector organisations. That is: Can developing economies replicate developed countries in their approach in implementing accrual accounting practices? This paper reports on an investigation into one developing nation's attempt to adopt accrual accounting as its financial reporting format. Findings suggest that, due to the nation's public service comprising a labor force with relatively low-level skills, high labour turnover and small investment in the required capital equipment (e.g., computer hardware), undertaking the migration from cash to accrual accounting for this and similar developing nations requires a different approach to that used by developed economies. This paper concludes with recommendations as to how to effectively bring about accrual accounting in developing nations.

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PAPER #: CS-2.2.2

TITLE: *An Examination of Factors Influencing the Decision to Obtain an Accounting Consultation*

AUTHORS:

Barbara Vinciguerra
Moravian College

ABSTRACT:

This paper examines factors that influence an auditor's decision to seek a formal accounting consultation in the resolution of a judgment based accounting issue. The consultation review is an important part of the firm-level quality control structure and the POB has recommended that audit firms reinforce the importance of consulting on important issues and vigorously enforce the policies by taking strong action when individuals do not consult when they should (POB, 2002). Specifically, this paper examines whether the following variables influence an auditor's decision to seek a consultation: size of client fees, perceived pressure from client management, and assessment of the aggressiveness of the accounting treatment. Results indicate that perceived aggressiveness of the accounting treatment is positively associated with likelihood of submitting the issue to the accounting consultation unit ($p = .013$). Perceived pressure from the client was found to be negatively associated with the likelihood submitting the issue to the accounting consultation unit ($p = .016$). The size of the client fees was not significant in the model. Implications for practice are discussed.

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PAPER #: CS-1.1.2

TITLE: *Standards for Determining and Alternatives for Reducing Executor Liability for an Estate's Federal Tax Obligations*

AUTHORS:

Donald Williamson
American University

ABSTRACT:

Personal representatives of decedent estates generally have personal liability for the payment of all estate taxes, both income tax and estate tax. In fact, the research indicates that this liability is almost absolute if the executor distributes estate assets to heirs so as to leave insufficient funds to pay the tax. Consequently, executors have a natural reluctance to distribute any funds to heirs before all statutes of limitation expire for the IRS to assess tax deficiencies. In addition to examining the extent of executor liability of estate taxes, the paper offers several statutory alternatives available to estate administrators and heirs to reduce their liability and thereby facilitate the efficient and prompt closing of estates. All executors and their tax advisors should be cognizant of the tax liability issues discussed in the paper, and in appropriate circumstances, elect an alternative that will relieve the executor of liability without reducing the ability of the IRS to collect tax revenue.

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PAPER #: CS-2.3.2

TITLE: *Linear and Nonlinear Models for the Power of Chief Elected Officials and Debt*

AUTHORS:

Jean Zhang
The George Washington University

ABSTRACT:

This paper proposes linear and nonlinear models to study the relationship between the power of the chief elected officials and debt. Using SAS and Higher Order artificial Neural Network (HONN) simulator I analyze debt of the municipalities as a function of population and length of CEO term. The linear models show that the length of CEO term and the amount of debt is inversely proportional to the amount of debt. Particularly, a longer length of CEO term leads to a decrease in debt, while a shorter-term length for CEO leads to an increase in debt. Additionally, I find the nonlinear models are about 1.00% better than the linear model in this study. Results from both models strongly reveal that the length of the Chief Elective Official (CEO) term is associated with the debt of local governments.

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SECTION III.

TEACHING FORUM ABSTRACTS

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PAPER #: TF-4.4.3

TITLE: *An Active X Governmental Accounting Educational Resource*

AUTHOR:

George Bodnar
Duquesne University

ABSTRACT:

The Active X software resource titled "Omnis Mus II" automates the preparation and processing of governmental accounting general fund journal entries. The paper first describes some pedagogy advantages of using the software when teaching governmental accounting general fund journal entries. It then describes the nature of the software and details its installation. The software is an Active X control that can be obtained and installed from the Internet. A basic general fund general ledger database is provided that should be usable with most textbooks. It could be modified as necessary, as long as one adheres to the software's chart of account rules.

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PAPER #: TF-4.4.4

TITLE: *Teaching Students in Accounting Information Systems and Auditing Courses How to Document, Test and Report on Internal Controls in Great Plans 8.0*

AUTHORS:

Stephen Fogg
Temple University

ABSTRACT:

This paper will examine the techniques that I have developed to help students understand the importance of internal controls and how to document and test controls and report on their findings. Students in sections of an accounting information systems course work in teams to document, evaluate and test the controls in place in different segments of a company that uses the Microsoft Great Plains information system (revenue cycle, expenditure, payroll, fixed assets etc.). Each team then prepares a report listing the controls that they uncovered, the test(s) that they performed to determine if the controls are effective in what they were designed to accomplish and any significant or material weaknesses found. The teams then make recommendations to members of management as to whether they should/should not sign the letter attesting to the effectiveness of their firm's controls, as required by the Sarbanes-Oxley Act. In the paper I summarize the difficulties that the students have encountered in approaching this project since I first introduced it over a year ago and the guidance that I have provided to help them successfully complete the work.

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PAPER #: TF-4.4.1

TITLE: *An Internet Tour of Streaming Videos Focused on Issues Surrounding the Accounting Profession*

AUTHORS:

Richard A. Johnson
Frostburg State University

Joyce M. Middleton
Frostburg State University

ABSTRACT:

The age of online streaming internet video featuring issues important to accounting professionals, educators, and students has arrived. This article examines several of the best free online sites. Topics of available videos include public accounting careers and the work of CPAs, recent frauds such as Enron and WorldCom, and the regulatory process surrounding accounting. The length of the available videos varies. Some are brief thirty second teasers and others are feature length productions or hearings lasting an hour or more. Consider the videos as a component of an overall blended teaching/learning strategy, interesting to the podcast generation. Videos are included from the AICPA, FEI, SEC, FASB, Frontline public TV, the Perlinger Archives, and the Yahoo and Alta Vista video search engines. The videos are an excellent resource for accounting professionals, educators, and students.

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PAPER #: TF-4.4.2

TITLE: *Reconciliation of Net Income to Cash Flow from Operations: A Conceptual Approach*

AUTHORS:

T.J. Wang
Robert Morris University

John J. Smigla
Myers University

ABSTRACT:

This paper describes a pedagogical approach to teaching the fundamental concept of reconciliation behind the indirect method of the statement of cash flows. This method focuses on students' higher-level thinking and analytical skills, and it embeds two interrelated aspects of teaching these skills: the organization of knowledge and elaboration during learning. A conceptual framework is created to demonstrate how the accrual- and cash-based methods relate to each other, and to illustrate the concept of reconciling these two methods. The conceptual framework recognizes additional categories of effects specified in the Statement of Financial Accounting Standards No. 95 regarding the indirect method, which makes the concept of reconciliation more thorough and complete. A basic comprehension of accounting terms, such as accrual, deferral, recognition, and realization, is a prerequisite for understanding this conceptual framework.

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