

**An Examination of the Employment Contract of Public Accounting Firm Employees:
The Application of Agency Theory to Professionals**

Elizabeth Dreike Almer, PhD, CPA
Assistant Professor Portland State University
School of Business Administration
P.O. Box 751
Portland, Oregon 97207-0751
Phone: (503)725-3729
E-Mail: elizabetha@sba.pdx.edu

Julia L. Higgs, PhD, CPA
Assistant Professor
Florida Atlantic University
777 Glades Road
Boca Raton, Florida 33431
Phone: (561) 297-3663
Fax: (561) 297-7023
E-Mail: jhiggs@fau.edu

Karen L. Hooks, PhD, CPA
Professor
Florida Atlantic University
220 SE 2nd Avenue
Fort Lauderdale, Florida 33301
Phone: (561) 297-3638
Fax: (561) 297-7023
E-Mail: khooks@fau.edu

Please address correspondence to Almer

Abstract:

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An employer/employee relationship that has not been previously addressed in the literature from a "professional serving as agent" perspective is that between the CPA firm and its CPA employees. Historically, agency theory has been used to explain principal-agent relationships, however, many of the assumptions of traditional agency theory do not hold when applied to professionals. This paper incorporates institutional features of accounting firms and sociology- and behavior-based theories to modify traditional agency theory to consider professional accountants. Based on these modifications a theoretical model of the employment contract between accounting firms and professional CPAs is proposed. The model is sufficiently flexible to accommodate the dynamic environment of public accounting. The model addresses what each party receives in the exchange, which includes what services are delivered to the employer and what the employee receives as compensation. The paper concludes with suggestions for future research.

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I. Introduction:

The public accounting environment is changing. Competition for audits is increasing (Houston, 1999) and CPAs working for the attest units of non-CPA companies such as American Express are now providing assurance services (Kelly, 1998). Shortages of experienced accountants abound (Stimpson, 1998) and have even been cited by one Big 5 firm as a contributing cause for closing an otherwise profitable office (Electronic Accountant, 1999b). New college graduates are less willing to work long hours and are insisting on more balance between work and personal endeavors (Shellenbarger, 1998b). Firms are expanding employee benefits to include items like flexible work arrangements and child care assistance (CPA Journal, 1996). In addition to technical skills, personnel are evaluated on behavioral skills such as subordinate management and practice development. Employees may be compensated for meeting group performance targets (Shellenbarger, 1998a). As a result, the relationship between firms and their CPA employees is changing dramatically and becoming increasingly complex.

Researchers have historically examined the relationship between a business owner and employees using agency theory. However, given the increasing complexities in the public accounting environment, agency theory as currently described in the accounting literature may not be sufficiently developed to explain details of the relationship between professional services firms and their CPA employees. Perhaps because of this limitation, researchers have also used other theories in addition to agency theory to explain the behavior of firms, their employees, and the relationships between them. Theories used to augment classical agency discussions include extensions of agency theory (Sharma, 1997), organizational behavior theories (Dirsmith and

Covaleski, 1985; Hooks, 1991) and psychological theories (Leana and Van Buren, 1999; Mitchell and Mickel, 1999; Morrison and Robinson, 1997).

The current paper advances a comprehensive employment model by expanding upon classical agency theory and incorporating elements of other theories. This extended model introduces elements of the work agreement specific to the relationship between CPAs and their firms.¹ The model set forth here provides a framework for examining issues arising from the relationship between public accounting firms and their professional employees. First, in order to provide a foundation for the model, the tenets and the limitations of classical agency theory are explored. Next, we posit a model of the employment contract that considers the work environment of professional accountants as well as professionalism, organizational and psychological theories. The paper concludes by suggesting questions for future research.

II. Classical Agency Theory, Limitations and Alternative Considerations

Tenets of Classical Agency Theory

Agency theory is a well-established economic perspective used to explain the relationship between owners and managers or between managers and subordinates. According to agency theory, the party delegating work is the principal, and the party completing work is the agent. The relationship between principal and agent is viewed as a contract, the focus of which is to ensure efficiency (Jensen and Meckling, 1976). As such, agency theory has been used to examine a variety of problematic issues that arise between principals and agents including executive compensation (e.g., Baker, Jensen and Murphy, 1988), accounting choices (e.g.,

¹ In the current paper, CPAs are defined as tax and audit professionals engaged in public practice. These two groups of professionals share an acculturation process as they have been trained in similar environments, are both obliged by a code of conduct and are charged with a social responsibility to protect the public interest. Because they share this background, the term CPA is also defined to include tax or audit trained CPAs currently engaged in consulting services. We do not include non-CPA consultants for purposes of this paper.

Warfield, Wild and Wild, 1995), conglomerate mergers (e.g., Amihud and Lev, 1981) and board relationships (e.g., Fama and Jensen, 1983a, 1983b).

A strict view of agency theory posits that the relationship between the principal and the agent is affected by incentives and the availability of information. Both parties are assumed to act in accordance with their own economic interests. The agent is assumed to be work and risk adverse. The principal's self-interest is to achieve the firm's profit-maximizing objectives. When there is information asymmetry between the two parties such that the principal cannot completely monitor the agent's actions, the agent has an *opportunity* to shirk. Whether the agent actually does shirk and not act in the best economic interest of the principal and firm is dependent upon *incentive* to do so. When the agent's interests do not coincide with those of the principal, the agent has an incentive to shirk. The incentive and opportunity to shirk combine to create a moral hazard. Under classical agency theory, the agent with both opportunity and incentive is expected to act in his or her own self interest, which may differ from the firm's best economic interest.²

Baiman (1982) and Namazi (1985) model agency theory to examine the use of employment contracts and information systems to create pareto optimal equilibria.³ The information system is used to inform the principal about the agent's performance thus reducing asymmetric information. To the extent that the agent continues to have private information that is not mitigated by the employment contract or captured by the information system, the principal assumes that the self-interested agent will shirk. The compensation to the agent is then adjusted for the expected level of shirking. At the extreme, the agent who does not shirk will demand a

²In classical agency theory, the agent is assumed to be totally self-interested. In the following sections, we will discuss situations where this assumption may not hold.

³Pareto optimal means that it is not possible to make one person better off without making someone else worse off.

monitoring system so that the assumption of shirking is disproved, and he or she will be fully compensated.

Agency theory proposes that the employment contract represents the relationship between what the employer pays and employee receives in salary and traditional benefits. Model 1 details this relationship.

Insert Model 1 about here

A compensation package composed of salary and traditional benefits are assumed to equal both the value of services received by the principal and total compensation received by the agent.

Thus, the employment contract reflects an equal exchange; value of the services received by the employer equals the value of the compensation package received by the employee. The equal exchange assumption is based upon the ability of either party to exit the contract as a result of imbalance or unfairness.

The value the employer receives in the exchange is the value of the employee-provided professional contribution adjusted for labor market effects; the professional contribution is the value of the work performed by the employee. The extent of the professional contribution under agency theory is affected by the effort of the agent, degree of the agent's expertise, shirking, and states of nature (environmental factors) beyond the agent's control. Shirking is related to self-interest, risk-preferences of the agent, bounded rationality⁴ and information asymmetry.

Regardless of the perceived or assessed value of the professional contribution, the employer will have to pay the market price for the agent's services. This market effect will cause the net cost of the services received to either increase or decrease. Thus, Model 1 shows the net cost of services

⁴ The concept of "bounded rationality" as first defined by Herbert Simon (1982) assumes that individuals are limited in their ability to attend to all possible decision factors, thus decisions are made without consideration of complete knowledge.

received by the employer to be the value of professional contributions received plus or minus labor market effects.

The other component of the exchange, in other words, the right hand side of the equation, is the compensation package received by the employee. Under basic agency theory this has been assumed to consist of salary and traditional benefits. Salary is a function of experience, expertise, and labor market pressures. Traditional benefits can be readily quantified in monetary terms and include vacation and sick leave, insurance and pension benefits and depend on market pressures and the firm's philosophy.

Limiting Assumptions and Alternative Considerations

In recent years researchers have begun to identify limitations of classical agency theory and suggest that agency theory will be more useful if expanded to include a wider variety of situations, principals and agents. For example, the employment contract between lay principals and professionals acting in a consultant capacity has been examined by Sharma (1997). Lay principal-professional exchanges envisioned by Sharma include relationships such as those between clients and accountants, lawyers, architects and physicians. The relationship between a CPA and his or her firm differs somewhat in that it involves an employer/employee relationship rather than a consultant/client relationship. It is similar because it also involves professionals. Sharma (1997) notes that in the management literature, "Business exchanges that involve professionals as agents provide a rich, yet noticeably under explored, arena in which to apply and evaluate agency theory" (p.788).

Others echo the belief that a further exploration of the application of agency theory will help us to better understand behaviors. However, further development of the theory may be needed to facilitate the desired understanding. Indjejikian (1999) notes "...descriptive and anecdotal examples of real-world practices coupled with the low explanatory power of most

empirical studies has led critics to claim that most employer-employee relationships and firms' compensation practices are far more complicated than standard principal-agency theory allows" (p. 152). Eisenhardt (1989) argues that, "The richness and complexity of agency theory would be enhanced if researchers would consider a broader spectrum of possible contracts" (p. 71). Within accounting, agency theory applications have been extended beyond pure economic modeling to include the examination of behavioral issues (Noreen, 1988; Harrell and Harrison, 1994; Harrison and Harrell, 1993; Rutledge and Karim, 1999). Based on the suggestions and guidance of prior research, we explore specific assumptions of the classical agency theory model that may limit our ability to understand the behavior of CPAs and their employing public accounting firms in a principal-agent relationship.

The first limiting assumption of agency theory is that of total self interest on the part of the agent. Even when CPAs, who are by definition professionals, are the employees party to an employment contract, agency costs are still expected to arise. The situation differs from that of classical agency theory though, because the assumption of a work-averse and self-interested agent is inconsistent with traits traditionally attributed to professionals (Hooks, 1991).

Altruism is often specified as a necessary component of the definition of a professional. Regarding altruism, most professions distinguish themselves by espousing a commitment to benefit society through their work. As members of these professions, individuals are expected to approach their work with some degree of altruism. This softens the agency theory assumption that the professional agent will act exclusively to further direct, short term, economic self-interest. The benefit promised to society by professionals is also purported to be explained by other motivations. Hooks (1992) argues that the accounting professions' actions benefiting society are not motivated by altruism, but rather by an attempt to maintain market control and manage social conflict. According to this perspective, professionals act in the interest of society

because they are awarded elevated status, such as the license to perform special duties, in return for protecting the public interest. Thus, professional agents act not out of altruism, but out of a desire to protect the social contract that awards them this elevated status.

Regardless of the motivating factor, it is often proposed that professionals behave in a manner that is not solely linked to their direct, short term economic self interest. It may be argued that the public-benefiting behavior contributes to the professional's self interest in an indirect or non-economic manner, as might be the case with an altruistic motivation. In contrast, perhaps a direct and economic, but long term self-interest motive, such as that resulting from the social contract, drives the socially beneficial behavior. Either explanation is consistent with significant complexity regarding the assumption of self-interested behavior on the part of an agent who is also a professional and an accompanying need to include more detailed variables in the model to explain this complex situation.

Agency theory also assumes that an employment contract needs either enforcement or that the agent's compensation be calculated based on expected shirking. An external monitoring approach is assumed as the primary and most effective means of holding the agent to performance of the contract. Research regarding professionals and their behavior suggests that various factors internal to the individual may also constrain shirking behavior. Further, the entire social structure of the professions is proposed to develop and nurture these internal controls (Larson, 1977).

Professionals conduct their work actively within the social structure of their particular profession. While “the profession” may not directly supervise the professional, his or her work occurs within a larger socioeconomic context in which there is oversight by a community of peers. This oversight can take the form of, for example, a code of ethics and licensure requirements. Therefore, it follows that the agent who is a professional possesses mixed motives.

He or she is proposed to be motivated by economic self-interest as well as the desire to behave as expected by the profession. As in the case of altruism, this desire to behave as an upstanding member of the profession might be described as self-interested motivation for other than economic returns. The agent is also subject to additional forms of monitoring beyond the employment contract, due to his or her professional stature.

Some accounting organizational theorists argue that social embeddedness, also advanced by Sharma (1997), explains the collective behavior of CPAs. Covaleski, Dirsmith, Heian and Samuel (1998) suggest that within the (then) Big Six public accounting firms, structural and societal control mechanisms are used to ensure congruence of individual CPA's work and lifestyle goals with those of the firm. This socialization is a process of indoctrinating members of the firm to behave in a certain way through a process of social learning within the organization. Similar socialization processes, invoked as a means of exercising control, can be found in university fraternities and sororities, military organizations, and religious groups (Fogarty, 1992). Given the internal and professional controls that are theorized to affect the behavior of professional accountants, modifying the agency theory assumption that monitoring is the sole influence on contract performance and shirking is proposed.

Another limiting assumption of classical agency theory is that all forms of compensation can be measured and described in terms of money. Classical agency theory assumes that money motivates agents to behave according to the interests of the principal. The agency model's employment contract includes only a single type of compensation for the agent's efforts – money – and ignores other non-monetary rewards. Mitchell and Mickel (1999) note that individual attitudes differ with regard to monetary compensation and that this, in turn, affects behavior. This difference in attitudes suggests that individuals may place differing value on non-pecuniary remuneration, as well. Since individuals attach different meanings to money, behavior cannot be

predicted by a simple assumption that more money is better than less, and will therefore motivate organizationally desired behavior. Money correlates positively with life satisfaction, but once a certain level of wealth is achieved, the marginal impact of additional money is diminished.

Recognizing the expanse and limits of money's motivational effect is important for those studying employment contracts, as well as for those designing them. Recent trends in professional services firms reflect compensation packages in which money or pecuniary benefits are only one component (CPA Journal, 1996). We propose that a better understanding may result from expanding the agency theory model to explicitly consider various forms of compensation. This might be particularly important when applying the model to agents with compensation packages that place them in relatively high income levels, would be the case when studying the contracts of professional accountants.

The last limitation of classical agency theory discussed here is the assumption that the principal and agent have mutually exclusive goals that typically are in conflict. In the case of the agent who is a professional, this assumption of conflicting goals may be inappropriate because co-production of the final product is a key feature of the relationship (Sharma 1997). Co-production of the product as is, for example, the case when a doctor and patient work together to determine the optimal treatment plan, creates a unique relationship between the two parties. This relationship has a bonding effect, motivating the professional agent to work harder for the benefit of the principal. Co-production of the product clearly occurs in the case of the CPA and its professional employees.

Leana and Van Buren (1999) refer to this bonding relationship resulting from co-production as social capital. They assert that the development of social capital is also a *means* of aligning the interests of principals and agents, as well as an outcome. Social capital is an asset reflecting the character of social relations within the firm. The asset can exist at both the firm

and individual level. By pairing agents and principals with similar goals, and nurturing these social capital structures, firms can mitigate the problem of the self-interested agent.

Psychological contracts are another aspect of any employment relationship that informs the assumption of conflicting goals between employer and employee. Morrison and Robinson (1997) describe the employee's understanding of the psychological contract as "employees' beliefs about the reciprocal obligations between them and their organizations." Components of the psychological contract can be stated or implied. The detrimental impact of psychological contracts is that if an employee perceives that the organization has violated the agreement the result can be goal conflict, dissatisfaction and turnover. Alternatively, in the situation in which the employee believes the employer is fulfilling its part of the contract, the existence of a psychological contract provides further support for the notion that the professional agent and employing firm may be allied in their objectives.

In summary, profession-related, organizational and psychological theories support the proposition that because professionals are subject to additional motivations, monitoring and controls beyond those described by classical agency theory, some of its assumptions may be unduly limiting and therefore inappropriate. In the next section, we draw upon alternative theories to relax these limiting assumptions and propose an employment contract model for the relationship between public accounting firm employees and their firms.

III: Proposed Employment Contract of Professional Accountants

An in-depth understanding of the relationship between the CPA and his or her employing firm is needed to consider ways in which the classical agency model should be expanded to represent the contract between the professional service firm principal and CPA agent. The analysis requires understanding the environment in which the agent works and other modifications relevant for accounting professionals. A significant consideration related to

accounting professionals is the complex and rich set of variables that can be leveraged as a part of the compensation package. Discussion and application of these relationships and environment variables follow.

Insert Model 2 about here

Employer Related Variables

Variables that are a part of what the employer must consider in deciding upon compensation are discussed in this section, and are shown on the left side of the equality in Model 2. They include value of professional contributions, cost of transitions and labor market effects.

Professional Contribution

As discussed earlier, the professional contribution component of the model is our description of employee activities associated with accomplishing the functions desired by the employer. The job of a CPA is multi-dimensional and includes many tasks such as technical work performed for the client, engagement management, subordinate development, administrative and recruiting activities, training, and practice development. The variety of activities for which the CPA is being compensated increases the difficulty of articulating and defining the professional contribution value. A fundamental issue is the assignment and measurement of the professional contribution. Is the CPA compensated for output based on “whether the job was performed,” input based on “number of hours it takes to get the job done,” or some combination of the two? Classical agency theory assumes *either* an output *or* input metric.

Although *value* should be similar, measurement of the professional contribution *cost* may differ between an output and input approach. As an example, suppose an employer pays an unskilled laborer \$80 to complete a task. If the goal is simply to have the task completed, then

the employer is indifferent as to how long the laborer works, how fast the work is performed, and whether the worker is efficient. On the other hand, if the employer pays the laborer \$80 for eight hours of work, then issues of efficiency and motivation become salient.

We assert that CPA firm metrics use neither input nor output approaches exclusively. Therefore, the versions of agency theory currently articulated in the literature do not fully explain what an employing CPA firm expects to receive from its CPA professional. Thus in Model 2, the variable labeled “value of professional contribution” is intended to capture both the output and input components.

While professional contributions for which CPAs are being compensated has not been clearly articulated in the literature, consideration of the public accounting environment supports our assertion that professional contribution measurement is both output and input based. From the individual CPA’s perspective, the compensation may simply be in exchange for “whatever it takes to get the job done.” This perspective is reflected in some employment arrangements in which CPAs are given a flat salary with little or no additional compensation, either in money or compensatory time off, for overtime worked. This view of professional contribution suggests that CPA-professionals are compensated for the product created, rather than for the sale of their labor.

In contrast, there is also an element of “common laborer mentality” in the way CPA employees are evaluated and expected to behave. CPAs typically are accountable for hours worked, even though the data are self-reported, since realization rates⁵ are tied to time budgets. Based on our understanding of the current public accounting culture and performance measurement strategy, it seems unlikely that the “superstar” who can complete a job in half the

⁵The term “realization rates” is used to mean the percent of revenue that is collected based on standard rates. Realization rates are one of the efficiency measures used by CPA firms.

time of his or her peers will only be expected to work a 20 hour week. An implicit corollary to the implicit directive of “do whatever it takes to get the job done” is, “work 40 hours *or more* a week.” In fact, fixed salary arrangements adopted in the mid 1980s by several large firms implies an employment contract under which employees are obliged to work some amount of overtime in excess of a 40 hour week (Berg, 1987). This suggests an input element of professional contribution measurement in addition to the output element. In summary, if the professional contribution for CPAs is in part based on hours worked and in part on productivity, then arguably, the compensation arrangements reflect contracts using multiple measurements, that is, a mixed contract.

Factors Influencing Professional Contribution

The effects of effort by the agent, degree of expertise and states of nature continue to be defined in Model 2 as they were in Model 1’s representation based on classical agency theory. Factors influencing shirking, however, are broadened and refined to more effectively capture circumstances of the public accounting environment for use in Model 2.

Regarding the environment, the firm cannot observe all of an individual CPA’s activities, and therefore the individual CPA retains private information. Assuming an input driven compensation system, this information asymmetry provides the opportunity for the individual to shirk. However, CPAs using the traditional evaluation method are penalized for working too few hours or going over budgeted hours. Thus, the input related opportunities for shirking are limited somewhat by the nature of the evaluation process. The private information effect is also mitigated by the work-product review universally conducted by public accounting firms, and the firm-principal’s knowledge regarding the input requirements for task performance.⁶ Shirking is

⁶ The standard time has built-in slack for factors beyond the professional’s control and beyond the observation of the principal such as availability of documentation and interruptions. The low profitability on audit services observed in recent years suggests that there may be very little slack in the audit function performed in traditional ways. These same ideas would apply to other components of the CPA professional’s portfolio including tax work,

also possible in output-based compensation schemes since although some of the CPA employee's activities such as practice development are observable and measurable, others such as oversight and development of subordinates are less easily measured.

Organizational and professional commitment are also expected to impact the degree to which a CPA chooses to shirk. The commitment constructs have been well documented in the literature (Ferris, 1981; Norris and Niebuhr, 1984; Gregson, 1992; Street, Schroeder and Schwartz, 1993) and have been found to affect job satisfaction and turnover (See Gregson, 1992, p. 81-82 for a list of research on the topic). Organizational commitment is related to an employee's loyalty to and aspirations within an organization. In the case of professional services firms, an individual's desire and aspiration to stay in the firm until a high level of experience is achieved or until he or she becomes a partner might be considered an observable measure of a high level of organizational commitment. This commitment concept will also be discussed later relative to the model's deferred compensation variable.

The issue of ethics has been raised in agency theory discussion and may affect the agency model for employee professionals (Noreen, 1988). Noreen argues that the opportunistic behavior assumed by agents under agency theory is tempered by ethics of the individual. The concept of ethics impacting behavior of an employee is similar to Sharma's (1997) reference to professional altruism. As we noted previously, what appears as altruism may simply be the professional behaving in a way that protects his or her privileged role in society (Hooks, 1991). In any case, be it an ethical predisposition, altruism, or a desire to protect one's role in society, some individuals will choose to spurn opportunistic behavior regardless of influences that might motivate other individuals to shirk.

Accountability is also proposed as an influence on shirking, and may ultimately

consulting, and outsourcing of accounting and internal audit functions, although the quantity of built-in slack has not been empirically examined.

be found to be related to the commitment or ethics variables. Although accountability theory, (Tetlock, 1983, 1985) has been tested in a variety of situations, its role for professional accountants in CPA firms has experienced limited study (Johnson and Kaplan, 1991; Messier and Quilliam, 1992). The focus for our model is whether accountability, as experienced by accountants who are professionals, influences the level of shirking in which they participate. Accountability may serve as a governing factor that influences professionals in the same way as do monitoring schemes for assembly line workers. Alternatively, it may have limited influence, or the influence may vary according to the task, individual to whom the professional feels accountable, etc.

The degree to which the employee feels that his or her psychological contract has been fulfilled may also affect work performance and level of shirking (Morrison and Robinson, 1997). Since the psychological contract relates to the employee's beliefs about whether the employer has fulfilled overt and/or implied commitments, this may directly impact loyalty, commitment, motivation and performance. If an individual believes he or she has been treated according to the perceived agreement, there may be less motivation to shirk.

Value of Transition

Our definition of the professional contribution variable relates to the accomplishment of an assignment without any interruptions, while working at 100 percent efficiency. This "professional contribution" state, as we have defined it, can never be achieved in practice. The "professional contribution" for an accountant is multi-dimensional and includes numerous activities that require switching from one dimension or task to another, and therefore, cannot be completed without interruption. Interruptions decrease productivity related to the professional contribution because the individual must stop to reorganize his or her thoughts and may have to reconfigure the workspace if the task is changed. Interruptions can result from numerous causal

factors such as unavailable documentation; telephone calls; questions from superiors, subordinates and peers; business conversations with clients; networking with fellow employees and the client; and rest breaks.

In Model 2, these interruptions are labeled “transitions.” Transitions affect the amount of work output that can be produced as a result of activity classified as professional contribution. Despite the fact that these transition activities are not “productive”, they are required for professional contribution activities to occur. The employer is expected to compensate the employee for transitions, because in order to accomplish professional contribution transition time is required. The variable, transitions, is included as a positive element in Model 2 since the employer must pay for these transitions as part of the employment contract.

Labor Supply Market Effects

In any market economy, the compensation package provided to employees is driven, in part, by labor market forces. Thus, one component paid to employees may be a discount or premium to adjust compensation for supply and demand labor economics effects. Recent trends in the accounting labor market indicate that at least during 1999 and 2000, firms may have been paying a salary premium (Electronic Accountant, 1999a). Evidence includes the myriad of benefits offered to retain employees, increasing entry level salaries, signing bonuses, etc. (Fleischman, 1999).

Employee Related Variables

Employee related variables are those items that the employee receives as a part of his or her compensation package. These include salary, benefits, development, flexibility, expected deferred compensation, and satisfaction of personal preferences, and are shown on the right side of the equality in Model 2.

Salary

The employee related portion of the employment contract is the value received by the individual CPA. The CPA's compensation package consists of six elements representing value identified above. The monetary amount of salary paid is typically a function of the CPA's experience and expertise, and labor market effects reflecting the supply of and demand for that experience and expertise.

Benefits

Benefits are considered a separate element in the employment contract model because the benefit packages received by professional accountants, such as employee assistance programs, often go far beyond those offered to non-professional laborers (CPA Journal, 1996). Many of these relatively new benefits are now considered a standard part of the professional employee's compensation package. For the CPA these often include: retirement savings plans, spouse relocation services, real estate assistance, healthcare insurance for same-sex partners, maternity leave, adoption assistance, concierge services, tax services, etc. These benefits may be a part of the current compensation package simply because of labor market influences. However, these benefits also enable the employees to work more efficiently while maintaining a better quality of life. Specific benefits offered by different firms appear to be driven by the firm's philosophy as well as employee demand.

Development

An element of value received by employees that is an implicit part of the employment contract, is opportunities for professional development. Professional development as used in the model, includes opportunities for growth of both technical and behavioral skills. Both types of skills are important because they contribute to human capital value, thus making the employee more attractive in the labor market. Technical development beneficial to CPAs includes training

on various subjects such as auditing and accounting standards, tax law, and industry expertise, and is provided through formal programs and on-the-job training.

In addition to formal training, behavioral development evolves informally from interpersonal interactions including mentoring relationships, observing colleagues, and other ill-defined processes. Behavioral development increases an employee's human capital value by enhancing social, managerial, and practice development skills. Dirsmith and Covaleski (1985) describe the behavioral characteristics of the accounting professional. They note that professions are characterized by a high level of indetermination, which involves activities not dictated by rules, but which concern the talent and personal charisma of the individual. They further note that mastery of this indeterminate factor is passed on through informal, interpersonal modes of communication and control.

A staff evaluation form currently used by one Big 5 firm exemplifies the importance of behavioral skills. Of more than 20 core competencies listed, only five deal with technical expertise. The remaining skills include practice management, leadership, practice and product development, ability to interact effectively with others, and human resource development. These dimensions on which CPAs are currently evaluated stand in stark contrast to the skill set identified twenty years ago by Jiambalvo (1979).⁷ Although the nine dimensions identified by Jiambalvo are still relevant, current evaluations emphasize a much broader set of management, marketing, and interpersonal skills.

⁷Jiambalvo's dimensions are as follows: (1) Understanding Accounting Principles, Auditing Standards., and Firm Technical Releases. (2) Planning Audit Work (3) Promoting Additional Services to Clients, (4) Revising Audit Programs, (5) Providing Appropriate On-The -Job Training (6) Recognizing Client's Significant Problems and Solutions Suitable for Inclusion in a Letter to Management (7) Reviewing work of assistants, (8) Obtaining the Cooperation and Respect of Client's Personnel and (9) Demonstrating an Area of Special Competence.

Flexibility

The flexibility variable of employee compensation is a fairly recent addition to the employment contract. A shift in attitudes and enabling technology has created changes for many in the profession. Schedules often enable employees to work in non-traditional places and at non-traditional times. This flexibility has value to many employees because it allows them to enhance quality of life while maintaining or enhancing their human capital (Hooks and Higgs, 2001). Flexibility has traditionally been an implicit part of the professional accountant's work environment, particularly at higher organizational ranks. The implicit flexibility was evidenced by the ability to conduct personal errands and business during normal business hours, and work a lighter schedule after the end of "busy season." At higher ranks, it also means receiving business phone calls at home on weekends, as well as other manifestations resulting from being on call "24/7." Currently, flexibility is often explicitly agreed upon between employee and employer and may involve more extensive arrangements than in the past. Flexibility has been shown to benefit both the employee and employer (Almer and Kaplan, 2001).

One high visibility example of flexibility is work from home or telecommuting arrangements. Homework arrangements may allow the employer to save on office space costs. It makes hoteling workable during periods of heavy office traffic. Whether under formal or implicit arrangements, employees work from home to save commute time, be at home for repairs and deliveries, provide emergency child care, and for a variety of other personal reasons (Hooks and Higgs, 2001). For employees who find working at home to be optimal, the flexibility permits simultaneously meeting personal goals and maintaining career progression (Hooks, 1992). Flexibility can be a valuable component of compensation if the employee desires to maintain his or her human capital, but also needs to fulfill personal or family obligations. The

flexibility component is determined by firm policy and attitudes, and the personal circumstances of each employee.

Deferred Compensation

An anecdotally recognized part of the compensation package of public accounting employees has traditionally been something we call “expected deferred compensation”. The deferred compensation component in Model 2 describes the expectation that the current per hour rate of compensation may be lower than market, with the understanding that a very high salary may be paid in the future, perhaps when the employee is admitted to the firm partnership or because the employee moves to a higher paying industry job.

An expectation of receiving deferred compensation may also be logically linked to a high level of organizational commitment. In other words, if a young CPA professional is highly committed to his or her organization, even though he or she is required to work very hard relative to the current level of salary compensation, part of the high commitment may be because of an expectation of “abnormally high” compensation in the future via either admission to the partnership or later movement to another organization.

Current labor force attitudes do not support an entrenched expectation of staying with one employer throughout one’s career. This lessens the likelihood that employees will accept deferred compensation as a major component of the compensation package. Historically, large CPA firms adhered to “up or out” promotion policies. This policy gave clear signals to employees that they were regarded by superiors as having potential for advancement to upper levels of the firm. Changes in the labor market and mix of services provided have caused many firms to discontinue the “up or out” approach, substituting a “contribute or out” policy in its place. Firms no longer have the luxury of disassociating employees who, although performing adequately, do not have potential for top management positions. The change in promotion

policies along with increased competition, a scarcity of skilled accountants in the labor supply and changes in attitude in the work force may all be affecting the deferred compensation variable of the employment contract. The expectation of deferred compensation will depend on the CPA's belief that she or he will be able to obtain future positions at higher compensation (either inside or outside of the firm) by sacrificing in the present.

Satisfaction of Personal Preferences

The personal preferences component of the model reflects job environment aspects that are specific to the individual CPA's wants, desires and motivations regarding work habits. Examples of personal preferences include the level of work effort the CPA is willing to exert and social interaction desired, the tolerable amount of job related stress and preferred amount of social loafing with fellow employees and the client. Influences on personal preferences include ethics, values, accountability, perceptions of fairness (Morrison and Robinson, 1997), self interest, altruism, and a myriad of other individual qualities. Personal preferences have been articulated in prior accounting research, and used as variables correlated to commitment. (See Gregson, 1992 for a review of commitment studies)

IV. Conclusions and Future Research

The model is a tool that may be useful in guiding the exploration of questions about public accounting professionals and their work environment. Research addressing business issues at the firm level may include the effectiveness of compensation package configurations, the current value placed on partnership opportunities by employees -- the deferred compensation variable of the model, input-output measurement considerations and their impacts on shirking, interaction of measurement approaches with billing strategies and profitability. Measuring the cost of producing a knowledge-based product and pricing it appropriately is very important in the current marketplace. Research into measurement approaches can help develop these processes.

Many unanswered questions are important to both the individuals and the firms involved. For example: How does the employment contract change when flexibility in time and place of work are explicitly documented? Does any difference exist when flexibility is implicitly measured by both firm and employee? Do these implicit and explicit agreements influence shirking, and, if so, is there an impact on the quality of the work product? Are productivity gains resulting from technology or flexibility appropriately considered in client-billing and employee compensation agreements? These questions reflect the need for more information about the complexity of public accounting market contracts and reflect significant research opportunities.

Agency research, along with organizational and behavioral findings, provides the basis for the extended public accounting employment contract model presented in this paper. The changing environment of public accounting has become more complex. Research must consider the complexities to produce valid information that can increase our understanding of the relationships and constructs.

The model presented includes a more comprehensive set of variables than prior models. Transition time is specified as an item that employers must purchase. Non-monetary compensation, including benefits, flexibility and the satisfaction of personal preferences is developed as an important component of the employment compensation package. Ethical and other professional influences are proposed to influence shirking. Additionally, expected deferred compensation is discussed as a compensation package element that has traditionally been an implicit part of CPA firm employment contracts.

Overall, the variables included in this paper's employment contract model should be expected to pervasively impact the work environment and work of CPAs. Issues as diverse as motivation, expansion of services, work quality, pricing, and firm profitability are all tied in some manner to the basic employment contract. The model introduced in this paper provides a

tool to help understand the comprehensive set of variables, and their relationships, affecting public accountants.

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