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The impact of professional standards on accounting judgments: The role of availability and comparative information

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ABSTRACT

Given scant research on the influence of the AICPA's Code of Conduct, this study examines the effects of professional standards for advocacy and integrity on a financial reporting decision. Based on the availability and priming literature, we test whether the current wording of two AICPA professional standards influence financial reporting decisions. Prior accounting research has documented cases where professionals were inclined toward a conservative or skeptical bias (Francis & Krishnan, 1999; Jenkins & Lowe, 1999) while other studies have documented an inclination toward a client-confirming bias (Hackenbrack & Nelson, 1996; Roberts, 2010). Our study examines whether using AICPA ethical standards as primes results in a neutral, unbiased financial reporting decision in a context in which there is substantial, yet inconclusive, evidence. Roberts (2010) documents the tendency for professionals to view integrity and advocacy as segregated objectives: one for promoting unbiased reporting, associated frequently with accounting-related decisions, and the other condoning client advocacy, typically associated with tax-related judgments. Hence, we test for availability effects based on separately-stated standards. However, the literature on comparative analysis explains that a combined concept containing counterbalancing features allows the participant to form causal relationships between the distinguishing components. This type of mental process brings the causal knowledge into working memory. Hence, a joint presentation of countervailing standards should result in a more balanced judgment, reflecting neither a conservative nor pro-client tendency.

The psychology literature suggests that heuristics, such as availability priming and comparative analysis, are more likely to affect novice decision makers (e.g., jurors, clients, new hires, students) than experts whose work experiences could drive the results. This study examines the responses of upper-level accounting majors, and the results show that the participants are inclined toward conservative decision making. Participants exposed to a separately-stated standard for integrity respond conservatively, just as they do in a control group without explicit access to the professional standard. Similarly, even when exposed to AICPA Rule 102-6 allowing client advocacy, they report conservatively. In contrast, when the prime is a joint presentation of the standards, participants respond with an unbiased decision, which differs significantly from the consistently conservative response by the control group as well as by the participants primed with an isolated standard. We conclude that two AICPA standards (as currently worded) are best understood when they are aggregated. Whether this finding holds for professionals is an empirical question for future

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research. The implication is that accountants' decision making could be enhanced by a revised professional standard reminding them to jointly consider the goals of unbiased decision making and justifiable client advocacy.

Introduction

Current professional standards issued by the American Institute of Certified Public Accountants (AICPA) include technical guidance as well as a Code of Professional Conduct. The Code applies to all AICPA members whether they are employed in public practice, industry, government or education. After reviewing the history of the AICPA's development of a set of ethical rules, Voynich (2005) notes that the existence of a code of conduct is unique to a profession and should guide behavior. Likewise, Libby and Luft (1993) reiterate the importance of the professional Code, and argue that the primary purpose of the Code is to influence professional decision making. To date, however, little is known about the behavioral effect of the professional standards.

The Code serves as the profession's overriding ethical guidance for applying technical standards whether they are principles-based or rules-based (AICPA, 2010; Moehrle, Previts, & Reynolds-Moehrle, 2006), and it emphasizes the importance of a member's integrity as "it is the quality from which the public trust derives and is a benchmark against which a member must ultimately test all decisions" (AICPA Code of Conduct, Section 54-Article III). In addition to the specific rule for integrity, the AICPA Code endorses Rule 102-6, which allows a member to act as a client advocate in "support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others" (AICPA Code of Conduct, Rule 102-6).[1] Prior literature documents the tendency for these standards to be perceived as segregated objectives: one for promoting unbiased reporting and the other for allowing client advocacy (Jenkins & Lowe, 1999; Roberts, 2010). We posit that these two standards are best understood when they are aggregated.

Although there has long been interest in measuring accountants' ethical attitudes and behavior (Loeb, 1971), it was a series of corporate accounting scandals that led the U.S. Securities and Exchange Commission to require disclosure regarding whether companies have adopted codes of ethics, and if not, why not. In addition, the Association to Advance Collegiate Schools of Business (AACSB, 2004) began to require that students learn ethics as a part of their business degree at an AACSB-accredited institution. Immediately after Enron, academe and practice increased their focus on accounting ethics. Smith (2003, p. 47) reports a speech by (then) AICPA President Barry Melanchon stating that "the profession's leadership must act to preserve a legacy of honor and integrity for future generations of CPAs. The profession must build upon its traditional values such as rigorous commitment to integrity."

Professional integrity is a desirable social norm, and it is relevant to the wider debate on principles- versus rules-based accounting, with Sunder (2010) arguing that whatever written rules exist, there is a need to give social norms a stronger role in restoring professional and personal responsibility in accounting. This sentiment is consistent with the AICPA presidential viewpoints on professional integrity expressed a decade ago and the importance of restoring the public's trust in accounting.

While the Code prohibits any action or lack of action that knowingly misrepresents financial information, it also condones client advocacy. Given the complexity of technical guidelines for accountants, expertise in interpreting financial rules is clearly a valued service. AICPA Rule 102-6 allows professional accountants to be an advocate for their clients when it is appropriate to do so. In fact, prior research on confirmation bias in financial accounting decision making has documented the tendency for some professionals to exhibit pro-client tendencies when client preferences are made explicit (Hackenbrack & Nelson, 1996; Hatfield, Jackson, & Vandervelde, 2011; Kadous, Kennedy, & Peecher, 2003; Roberts, 2010). In the absence of stated client preferences, research has found that experienced professionals tend to respond with conservative, income-decreasing outcomes (Francis & Krishnan, 1999; Jenkins & Haynes, 2003; Lord, 1992).

If decision makers in accounting have either conservative or pro-client tendencies, unbiased judgments that are promulgated by the AICPA could be affected. Nelson (2003) argues that professional standards for accurate, unbiased reporting should be designed to incentivize appropriate decision making, yet no study to date has examined whether the profession's standards for advocacy and integrity impact financial decision making.[2]

The present study examines the impact of current professional standards for integrity and advocacy on upper level undergraduate students who are not yet familiar with these standards but soon will be faced with how to apply

[1] These AICPA standards were also adopted by the Public Company Accounting Oversight Board as its interim standards in April 2003.

[2] Some prior research on accounting ethics has been motivated by Kohlberg's (1973) theory of cognitive moral development and operationalized through the use of Rest's (1979) Defining Issues Test (DIT). There are numerous accounting ethics studies using the DIT (e.g., Abdolmohammadi, Read, & Scarbrough, 2003; Bay, 2002; Shaub, 1994; Tsui & Gul, 1996). These studies tend to report a resulting "P" score by which the ethical attitudes about a particular sample may be inferred and compared to other samples. Results, so far, have shown that the effectiveness of DIT applications to the accounting environment vary with participants' functional area of accounting and one's current level of moral development (Herron & Gilbertson, 2004; Scofield, Phillips, & Bailey, 2004). Bailey, Phillips, and Scofield (2005) assert that more research is needed to identify factors that mediate moral reasoning for accounting-related judgments. Given the costly and time consuming aspects of the DIT, the present study does not examine the DIT. Instead, our study builds on prior research regarding accountants' propensity towards implicit biases and tests how standards in the current AICPA Code of Conduct might influence accountants' decision making.