

Regulatory Overload, Individual Cognition, and Professionalism in the Accounting Field

Mohamed A. Elbannan¹, Ph.D.

¹ Minnesota State University Moorhead, USA & Cairo University, Egypt

Correspondence: Mohamed A. Elbannan, Ph.D., Paseka School of Business, Minnesota State University Moorhead, MN 56563, USA. E-mail: mohamed.elbannan@mnstate.edu

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Abstract

The purpose of this paper is to examine some determinants of the quality of accounting information. This paper focuses on causes occurring at the individual accounting practitioner's level that contribute to the perceived usefulness of accounting information. Practitioners are argued to respond to the pressures, created by multiple layers of regulatory, professional and organizational rule making bodies, by a feeling of defenselessness that emanates from possible disagreements with established rules. Practitioner frustration with these rules (which are sometimes perceived as dogmatic) and the impending threat of litigation forces practitioners to conform to these rules. Not only does this frustration reduce the capacity of the practitioner to act professionally, but also attaches a stigma to the practitioner's self-perception.

Keywords: accounting failures, FASB, cognition, CPA

1. Introduction

The purpose of this paper is to examine some determinants of the quality of accounting information. This paper focuses on causes occurring at the individual accountant's level that contribute to the perceived usefulness of accounting information. While accounting scandals are publicly identified and resonate rather loudly with accounting information, most users would still recognize accounting information as a significant source of credible information. The changes over the past several decades in market structure, technology, and investor taste have been drastic. However, the demand for accounting information has nevertheless remained strong. In a 2016 report, Deloitte concludes that "a periodic report that provides a summary of the business "as a whole" will continue to be a cornerstone of corporate reporting to investors" (Deloitte, 2016). The report also claims that "investors will continue to want, and need, management to provide a periodic summary of their business. That report is management's opportunity to tell their story, within a framework of widely accepted high quality standards." (Deloitte, 2016).

The accounting profession has weathered several adverse events over the past few decades where the very reasons for existence of the accounting function have been challenged. From instances of corporate fraud to allegations of standard-setting biases towards the large preparers, these instances may have had strong impact on the profession. The passage of Sarbanes-Oxley (SOX) act in 2002 is as much a sign of public inclination on the part of the wider accounting community to regulate the profession as it is an effort to curb accounting fraud and restore the credibility of the accounting information. A significant part of the SOX act is concerned with emphasizing and strengthening the independence of the individual accounting practitioner. These practitioners play a variety of roles with respect to financial bookkeeping, auditing, control, and information systems.

Accountants play an important role in the accounting profession. They act as the medium of application of accounting standards into publishable accounting reports. To be considered useful, accounting information must possess as much as possible of the desired qualities stated in the FASB Conceptual Framework (Palmrose & Kinney, Jr., 2018) as primary and secondary characteristics of accounting information. The behavior of individual accountants that contributed to the perception of a compromised accounting professional are numerous and worth noting. Several violations of accounting standards and criminal acts that have constituted bases for legal action by the Securities and Exchange Commission (SEC) against CPAs and/or accounting professionals who committed these violations at their firms are documented by the SEC (Note 1). While several studies have attempted to explain failures in accounting, the studies that offer explanations based on studying cognitive processes at the individual accounting practitioner's level are scant.

Accordingly, this paper proposes a cognition-based theory that suggests explanations for the behaviors of the individual accounting practitioners. In the light of the proposed theory, potential future choices by accounting practitioners may be predicted. The theory is grounded in cognition theories that offer explanation for individual behaviors.

The significance of the argument in this paper stems from the argument that accounting failures start from the ground and work their way upwards. The recent institutional changes in the accounting profession has aimed at raising the expectations in the behaviors of accountants and auditors (hereinafter, “practitioners”; Capoccia, 2016). In addition to pressures from the general public and the investment community, these changes have been brought forward by the passage of the SOX act in 2002 and the ensuing establishment of the Public Company Accounting Oversight Board (PCAOB). The stated purpose of SOX is “to protect investors by improving the accuracy and reliability of corporate disclosures” (SOX, 2002). The SOX act is comprised of eleven sections that strengthen auditor independence, emphasize transparency in management disclosures, improve quality of information, and increase the observation of ethical principles in accounting decisions. To institute these changes, SOX required the creation of the PCAOB, which is entrusted with monitoring and regulating the auditing community and raised the bar with respect to the professional independence of CPAs. SOX also requires that the board of directors of all public firms create an audit committee that would be responsible for the appointment and communications with the external auditors. The PCAOB “oversees the audits of public companies and SEC-registered brokers and dealers in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports” (PCAOB, 2009).

The arguments in this paper stem from the individual practitioner’s exposure to the high level of formality characterizing the practitioners’ environment. In such a setting, accountants are expected to follow the rules (GAAP) prescribed by the standard-setting body (FASB), professional rules instituted by the AICPA Code of Professional Conduct, the rules set by their respective employers, and the norms of society. The multiplicity of layers of rules create pressure for strict compliance by the practitioner and often present formidable (and sometimes conflicting) challenges to the practitioner’s career development. Some of these rules may be perceived negatively by the practitioner (Klein, 2009) and engender a feeling of defenselessness against public allegations of failure. and the personal need to engage in behaviors consistent with their adopted “watchdog” image. These processes negatively affects the practitioners’ on-the-job reflection, making them feel stagnant, passive, and detached from public needs, resulting in damage to practitioners’ professionalism. The end result is a downward spiral of deterioration in practitioners’ professionalism and increased formalization at the organizational level that further reinforces the antecedents of deteriorating professionalism.

This paper contributes to extant literatures by offering explanatory arguments that focuses solely on the cognitive processes driving individual accountants’ choices. Prior studies explored the dynamics taking place at FASB standard-setting and other settings (Bertrand, Bombardini, & Trebbi, 2014; Crawford, Ferguson, Helliard, & Power, 2014; Elbannan, 2008) and drew upon multiple literatures to explain accounting failures in general (Linsley & Shrivs, 2009; Schillemans & Busuioc, 2014). Discussion of processes taking place at the accountant’s cognitive processes has not evolved at the same pace and remains scant.

2. Cognition and Schemata

The arguments proposed in this paper are grounded in the managerial cognition literature. The seminal article in the managerial cognition literature by Weick and Roberts (1993) uses concepts such as schemata, cognition, and causal textures to characterize an environment as a learning environment where the schemata is being used by the participants to respond to situations (Dixon, Weeks, Boland Jr, & Perelli, 2017; Weick and Roberts, 1993). The natural inclination of the professional’s schemata is a central concept in this thesis and is considered basically as the set of convictions accumulated by an individual in the course of his or her prior professional experiences (Harper, 2015).

Professionals seek confirmation of their schemata by forcing their schemata-based views on situations, encounters, and events. Participants are argued to use their experiences to confirm schemata rather than update their schemata based on their newly acquired experiences. Based on this reasoning, the schemata controls perceptions of professionals and can be a tool for understanding professional behaviors because professionals constantly re-enact behaviors as taken-for-granted routines, which then becomes objectified into institutions over long time (Argote & Guo, 2016). As the established schemata gains social consensus at the practitioner’s level, managerial cognition creates the basis upon which the world is interpreted by the practitioner and hence constitute an important self-perpetuating driver for individual and organization action.

3. Domination of Externally Imposed Rules

Past experiences build into the cognition of individual practitioners a sense of need to maintain an air of independence in a regulated profession. However, practitioners need to continually exhibit their compliance with standards, rules, and norms to avoid legal consequences. This strong rule-orientation of the profession became institutionalized in the individual and collective minds of consecutive generations of practitioners. One of the concerns for practitioners is audit failures, which may drag a practitioner into lawsuits ending in heavy reputation and financial losses. Since the incidence of the accounting scandals in the early 2000s, practicing auditors have been subject to increasing scrutiny and allegations of lack of independence. The examples of Enron and Worldcom are well-known examples. Many of these concerns have been the bases for the ensuing adoption of legislation aimed at regaining public confidence in the profession. For example, the SOX act prohibits auditors from the provision of non-attestation services to current attestation services clients and mandatory rotation among auditors.

Many of the auditors' behaviors that were subject to public criticism originate at the CPA firm level, including ineffective client management practices, futile audit practices, and/or unrealistic expectations from the audit team (Knechel et al., 2012; Schmidt, 2012). For example, more than half of the companies declaring bankruptcies did not undergo going-concern tests before they went bankrupt (Ragunandan & Rama, 1995). These adverse situations are expected to have a negative impact on the practitioners, who arguably experiences the conflict between the pronounced function of accountants and actual practices as chasm in the schemata of the individual practitioner. The regulatory intervention (i.e., the passage of SOX, the establishment of PCAOB, etc.) following the series of publicized incidences cast a negative shadow on the practitioners. They may respond to the increased formalization and deterioration in professionalism by a reduced desire for professional learning and reflection by the practitioners (Vlaar, Van Den Bosch, & Volberda, 2007).

4. Stagnation and Conformity

In their response to environmental pressures, practitioners are expected to behave in a manner that is consistent with strict following of the rules. Consistent behaviors where one strictly follows authoritative rules and procedures results in conservative judgment, reduced appreciation for creativity, and identification with higher bodies to avoid accountability (Morris and Liu, 2015). In a sense, practitioners are "shielded" from public accountability through strictly adhering to professional and regulatory rules without risking exercising professional creativity as much as possible. Results of a survey of perceptions of corporate reporting documented in Deloitte (2016) agrees with this conjecture. The survey concludes that "A company can enhance or damage its reputation value through the way it behaves, but also by how it reports. In a survey of 85 investors, 80 per cent said that their perception of the quality of a company's reporting impacts their perception of the quality of its management; and 63 per cent said that disclosure in an annual report about strategy, risks and opportunities and other value drivers can have a direct impact on a company's cost of capital".

Feeling the weight of the formal legal responsibility, practitioners, like other professionals, may be motivated to be less creative and more compliant with rules and procedures (Distelhorst & Locke, 2018). As they progress through their careers, practitioners are expected to exhibit behaviors that are consistent with (understanding and) conforming to rules and procedures and continually developing skills and knowledge through institutionalized means. Maintaining certification as well as progressing in career path are mostly based on "time"-based indicators (e.g., hours on engagements, continuous education credit hours, etc.) and evidence of good conduct, which typically includes strictly following set procedures and policies. While these expectations are prerequisites for growth and success, they may also be vehicles for promoting stagnation, inbreeding, and a "playing it safe" mindset.

5. Performance Evaluation in Other Professional Fields

Contrary to the meaning of professionalism, which implies a sense of taking initiatives, challenging, and thinking outside the box, organizational pressures may have de-professionalized the accounting field. The pressure to follow orthodox methods of managing practitioners may have hampered the evolution of accounting as a valuable function for the overall economic good. Prepares and auditing firms mostly follow hiring and compensation policies that serve to institutionalize policies that relegate practitioners to an undeservedly less professional role. Instead of evaluating auditors on billable hours, they, like other professionals, could be evaluated based on (a) personal goals through which individual practitioners' performance is measured and (b) CPA firm goals that could be used for strategic planning.

Traditionally, an auditor's performance has been evaluated based on a variant of a periodic review by a supervisor based on duties specified in the auditor's job description or some other organizational expectation yardstick. I argue that performance evaluation needs to objectively understand different practitioners' attitudes toward work and to entail techniques that are understanding of these attitudes and motivating to reach *personal* goals, potentially in a

self-evaluation environment. The results of following such an approach could be very well in the best interest of the employers as well. First, they will probably realize that they have access to a variety of attitudes, styles, and skills on their hand for use in a variety of contexts. Second, they would have demonstrated their understanding of the individual needs of each practitioner and would hence respond accordingly. Third, they would tailor the compensation and career path to each individual practitioner's aspirations. In this regard, the accounting professionals fall behind other professional groups such as physicians and engineers, who, as a group, have adopted potentially more professionally nurturing evaluation systems for their members than the accounting professional has (Note 2). Aside from the fact that different professions may stress different professional skills differently and that they have their own negative views on the development of performance evaluation in their own fields, one can learn from observing the conduct of evaluations in other professional fields Lander, Heugens, & van Oosterhout, 2017). For example, Zill et al. (2014) and Burt et al. (2018) stress the significance of incorporating measures evaluating communication effectiveness of medical professionals in their performance evaluation.

6. Conclusion

This paper proposes a link between the seemingly public dissatisfaction with the accounting profession to the individual cognitive dynamics at the practitioner's level. The arguments, grounded in academic theory, see the performance of accounting professionals as the result of an interrelated set of behavioral drivers that are motivated by burdensome professional environment of complex, changing rules imposed on the accounting practitioners. Practitioners are expected to comply with a multiplicity of rules, regulations, and policies that are imposed by multiple parties: FASB, AICPA, and auditing firms resulting in a pressure to act consistently with these rules or else risk jeopardizing one's job security and prospects. Being a highly specialized field, members of the field find the high pressure to essentially relegate them from their professional status. Creative thinking and taking initiative are not a highly prized traits of accountants in the field, and the result would seem to be a stagnant profession where the entire society suffers from a suboptimal allocation of resources among investment opportunities due to the lack of a dynamic profession that actively adapts to economic, legal and market changes.

Based on these arguments, I propose that for the accounting field to successfully regain public confidence, the practitioner needs to be treated as a professional again. A career path that recognizes the professional status of a practitioner is one that values learning, initiative, leadership, and self-guidance higher than external regulations and conformity. The profession needs to embrace the developments in technology, finance, investment, and law and needs to reinvent the role of the practitioner in the midst of these developments so that the practitioner would not find himself or herself out of touch with the rest of the world. However, the starting point could be the performance evaluation of accounting practitioners.

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Notes

Note 1. Examples of GAAP violations and/or professional misconduct are abound. The SEC keeps a repository (“Accounting and Auditing Enforcement Releases”) that contains reports on individual cases filed against perpetrators of violations. The repository is accessible online at <https://www.sec.gov/litigation/friactions.shtml> (visited on November 21, 2018).

Note 2. See, for example, Burth et al. (2018), Li et al. (2017), and Overeem et al. (2012) for research on the performance evaluation of medical professionals.