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# A STUDY OF THE EFFECTS OF COMPILATION AND REVIEW REPORTS ON CPAS' AND BANKERS' PERCEPTIONS OF THE RELIABILITY OF FINANCIAL STATEMENTS

By

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ABSTRACT

A STUDY OF THE EFFECTS OF COMPILATION AND REVIEW
REPORTS ON CPAS' AND BANKERS' PERCEPTIONS OF
THE RELIABILITY OF FINANCIAL STATEMENTS

By

Larry Joe Rankin

This thesis empirically tested the effectiveness of the communication process between CPAs and bankers within the framework of financial reporting for nonpublic businesses. The aspect of the communication process investigated was the similarities with which CPAs and bankers perceive assurances about the reliability of financial statements accompanied by no CPA report and statements accompanied by the CPA's compilation report, review report, and audit report. Reliability was defined as the extent to which financial statements are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of material unintentional errors, (4) free from the effects of material management fraud, (5) free from the effects of material employee fraud, and (6) evaluated by a CPA who is independent of management.

Questionnaires were mailed to 200 randomly selected Michigan CPAs, 130 randomly selected Michigan commercial bank loan officers from large banks, and 70 randomly selected Michigan chief executive

officers from small banks. The questionnaire depicted four conditions: no CPA association with the financial statements and statements accompanied by the CPA's compilation report, review report, and audit report. Following each condition, the CPAs and bankers rated each of the six reliability surrogates on a seven-point rating scale which ranged from "no confidence" to "complete confidence."

The following conclusions resulted from the analysis of responses:

1. CPAs and users do not share similar views about the reliability of financial statements when the statements are accompanied by the CPA's compilation report, review report, or audit report. For each of these reports, users attribute less assurances to the reliability of the statements than CPAs.

2. Both CPAs and users perceive differences in the reliability of financial statements accompanied by no CPA report, compilation report, review report, and audit report. CPAs and users correctly perceive that CPAs provide increasing assurances about the reliability of the statements in the order of compilation reports, review reports, and audit reports.

The findings indicated that users do not attribute audit-type assurances to compilation and review reports. The findings also suggested that the accounting profession has successfully implemented an assurance level approach with respect to CPA reports on financial statements of nonpublic businesses.

## DEDICATION

To the Lord Jesus Christ, Son of God,
Who provides assurances to man about
forgiveness, salvation, and eternal life.

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Several other people were instrumental in the completion of this dissertation. Theresa Hornsby assisted in typing early drafts of the dissertation. Jo McKenzie typed the final draft. Boonreang (Nid) Kajornsior was extremely helpful in writing computer programs. Ellen Foxman and Margo Bogart contributed significantly to the dissertation with their editorial comments.

I am very thankful for the special friends who greatly encouraged me during my doctoral studies. I particularly appreciate Pearl Bera, Carol Johns, and the James Bilby family for their loving friendship and spiritual support. I also owe much to the congregation at

the Saginaw First United Methodist Church and to the camp staff at Lake Louise for their encouragement. Finally, I am especially grateful to my loving parents and family for their faithful support and assurances.

TABLE OF CONTENTS

## LIST OF TABLES

| Table | | Page |
|---|---|---|

LIST OF FIGURES

# CHAPTER I

# INTRODUCTION

## Overview

This thesis empirically tests the effectiveness of communication from certified public accountants (CPAs) to bankers within the framework of financial reporting for nonpublic businesses. The form of communication between a CPA and a banker is related to the function performed by the CPA. When there is no association by a CPA with a firm's financial statements, no report is issued. But when CPAs do associate with financial statements, they provide assurances about them by issuing either a compilation report, review report, or an audit report. These three different types of reports represent increasing levels of assurance which a CPA provides to the management of a nonpublic business. Other individuals outside the firm (users) have a need for the information contained in the financial statements and the CPA's assurances about the statements, because they make economic decisions based on these documents.

While assurances about financial statements can take a number of forms, the form of assurance investigated in the present study is the reliability of financial statements. For the purposes of this research, an aggregate definition of reliability is used.

This research focuses on a perceptual link in the CPA-banker communication process. The study concerns the similarities with which CPAs and bankers perceive assurances about the reliability of financial statements presented under varying conditions: (1) when there is no CPA association with the financial statements, (2) when the statements are accompanied by the CPA's compilation report, (3) when the statements are accompanied by the CPA's review report, and (4) when the statements are accompanied by the CPA's audit report. The primary objective of the study is to test research hypotheses about the perceptions of CPAs and bankers.

A questionnaire was used to assess the perceptions of randomly selected Michigan CPAs and bankers. The questionnaire depicted four conditions: no CPA association with the financial statements, a CPA's compilation engagement, a CPA's review engagement, and a CPA's audit engagement. Following each condition, respondents rated the reliability of financial statements on a seven-point scale. Parametric statistics were used to test specific hypotheses about the data.

The research contributes empirical information about the CPA-banker communication process, particularly when compilation reports and review reports are issued by CPAs. Further, the study provides information on the extent to which CPAs and bankers understand that increasing assurances about the reliability of financial statements are provided by CPAs in the order of compilation reports, review reports, and audit reports.

## Organization

This chapter, which introduces the present research, includes the definition of terms, CPA-banker communication, the meaning of reliability, the need for research, objectives, research methodology, and contributions.

Following the introductory chapter, Chapter II reviews previous empirical research which is relevant to the present study. However, this research is not limited to the perceptions of bankers; different user groups' perceptions are described. The review covers the different types of CPA reports on historical financial statements, and CPAs' and users' perceptions of the reliability of these statements.

Chapter III reviews legal cases which uncovered problems in the CPA-user communication process with respect to unaudited financial statements. The purpose of this review is to describe examples in which CPAs and users did not share similar perceptions about the substance of the CPA's engagement, or CPA assurances accompanying unaudited financial statements.

Chapter IV is a chronological review of significant events and technical accounting pronouncements which preceded the development of compilations and reviews. The chapter reviews how these events and pronouncements were related to problems associated with unaudited financial statements and limited procedure engagements. The chapter then describes how the accounting profession's authoritative body responded to these problems by issuing a separate compilation and review standard.

Chapter V discusses the methodology used in the present study to empirically test the effectiveness of communication from CPAs to bankers. Topics discussed are: the research questions and research hypotheses, the questionnaire, the selection and responses of the CPA and banker groups, and the statistical analyses.

Chapter VI presents the empirical results of the present study. The chapter explains the data, the results of the statistical tests, and the meanings of these data and tests. Tables and graphs are used to support the presentation.

Finally, Chapter VII summarizes the present study's results, presents the conclusions and implications of these results, describes limitations of the results, and suggests topics for future research.

## Definition of Terms

The following terms which are used throughout the present research have these specific definitions:

Association with Financial Statements: A CPA is associated with financial statements when he (1) allows his name to be used in a written communication containing the statements, or (2) prepares financial statements which do not contain his name on the statements.[1] The present research refers to three types of CPA engagements--compilations, reviews, and audits--each providing a different level of assurance about the financial statements. The research also refers to situations in which there is no CPA association with the financial statements.

Assurance Level: The level of assurance is the degree to which a CPA is confident that financial statements are fairly presented in conformity with generally accepted accounting principles. Care must be taken to avoid assuming that the achieved level of assurance is the same as the expressed level of assurance. The achieved level of assurance is that level of confidence the CPA actually has about the

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[1] American Institute of Certified Public Accountants, Statements on Auditing Standards: Numbers 1 to 38, reprinted in AICPA Professional Standards, Volume 1 (Chicago: Commerce Clearing House, Inc., 1981), sec. 504.03 (hereafter cited as AICPA, Statements on Auditing Standards: 1-38).

financial statements.[2] The expressed level of assurance is that level of confidence communicated by the CPA in a written report about the financial statements.

Audit of Financial Statements: An audit is a type of CPA involvement with the financial statements of either public or nonpublic businesses. The objective of an audit by a CPA is to determine whether the financial statements are presented in accordance with generally accepted accounting principles applied on a consistent basis.[3] Auditing procedures performed by a CPA include an evaluation of internal controls, tests of transactions, and tests of account balances.

Compilation of Financial Statements: A compilation is a type of CPA involvement with the financial statements of nonpublic businesses. The objective of a compilation by a CPA is to present management's representations in the form of financial statements without expressing any assurances about the statements.[4] Compilation procedures performed by a CPA include preparing and reading the financial statements.

Financial Statements: Financial statements present financial data and accompanying notes, which are derived from accounting records. They

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[2] Alvin A. Arens and James K. Loebbecke, Auditing: An Integrated Approach, 2nd ed. (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1980), p. 142.

[3] AICPA, Statements on Auditing Standards: 1-38, sec. 110.01.

[4] American Institute of Certified Public Accountants, Accounting and Review Services Committee, Statement on Standards for Accounting and Review Services Number 1: Compilation and Review of Financial Statements (New York: AICPA, 1979), par. 4 (hereafter cited as ARSC, Compilation and Review of Financial Statements).

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are intended to communicate the economic resources and obligations of a business at a particular time or the changes therein over a period of time.[5] The present research refers to three types of financial statements: balance sheet, income statement, and statement of owner's equity.

Nonpublic Business: A nonpublic business is a profit-seeking entity which (1) does not trade securities on either a stock exchange or over-the-counter market, (2) does not make a filing with a regulatory agency in preparation for the trading of securities, and (3) is not a subsidiary of or controlled by a public business.[6]

Reliability of Financial Statements: Generally, the reliability of financial statements refers to the faithfulness with which the statements represent what they intend to represent, combined with an assurance for the user, that they have that representational quality.[7] The present research defines reliability as the extent to which financial statements are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of an existing material unintentional error, (4) free from the effects of an existing material management fraud, (5) free from the effects of an existing material employee fraud, and (6) evaluated by a CPA who is independent of management.

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[5] AICPA, Statements on Auditing Standards: 1-38, sec. 621.02.

[6] Ibid., sec. 504.02.

[7] Financial Accounting Standards Board, Statement of Financial Accounting Concepts Number 2: Qualitative Characteristics of Accounting Information (Stamford, Connecticut: FASB, 1980), par. 59 (hereafter cited as FASB, Qualitative Characteristics of Accounting Information).

Reliance on Financial Statements: Reliance on financial statements is the use of financial statements as a basis for decision making. Users may be said to rely on financial statements when their perceptions of the reliability of the statements help them to make economic decisions.

Review of Financial Statements: A review is a type of CPA involvement with the financial statements of nonpublic businesses. The objective of a review by a CPA is to perform analytical and inquiry procedures which provide the CPA with a reasonable basis for expressing limited assurance that no material modifications should be made to the statements in order for them to be in conformity with generally accepted accounting principles.[8]

## CPA-User Communication

Figure 1-1, adapted from the American Accounting Association's "A Statement of Basic Auditing Concepts" (ASOBAC), depicts the financial reporting framework for nonpublic businesses.[9] Within this framework, CPAs perform two roles: investigation and communication.

ASOBAC describes the CPA's investigative role as obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria.[10] The three types of investigation shown in Figure 1-1 are compilation, review, and audit engagements.

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[8] ARSC, Compilation and Review of Financial Statements, par. 4.

[9] American Accounting Association, Auditing Concepts Committee, "A Statement of Basic Auditing Concepts," Accounting Review (Supplement) 1972, p. 27.

[10] Ibid., p. 35.

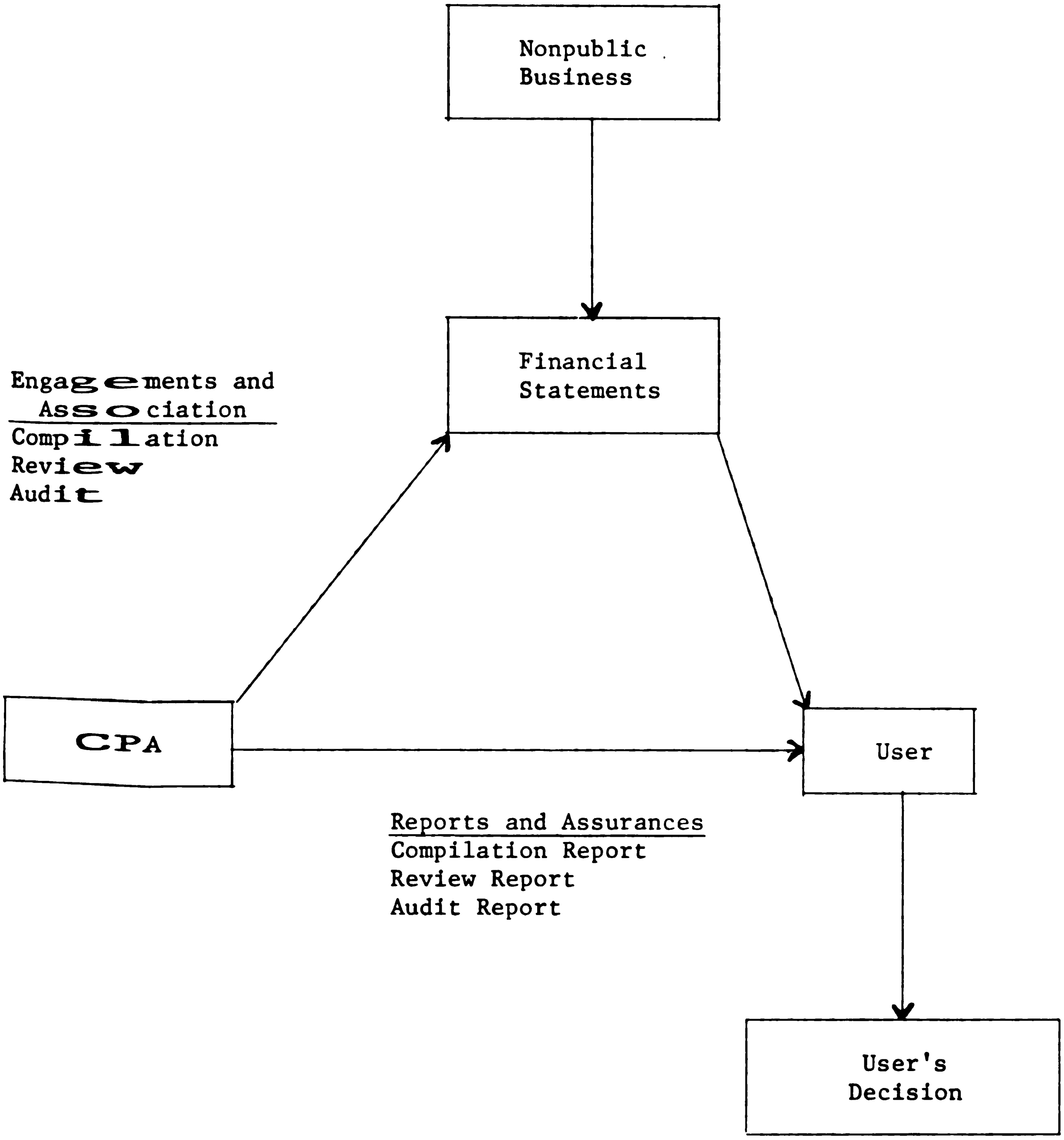


Fig. 1-1. Financial reporting framework for nonpublic businesses

That is, in compilations and reviews, a CPA reads the financial statements to determine if the statements are appropriate and free from material errors. Additionally, in reviews and audits, a CPA performs analytical and inquiry procedures. Furthermore, in audits, a CPA performs substantive and compliance tests and evaluates internal controls. The present study does not emphasize the investigative role of CPAs, but rather the communicative role, as defined in ASOBAC.

ASOBAC describes the CPA's communicative role as expressing the results of the investigative process to users of accounting information.[11] This communication helps users to assess the extent of the reliability of financial statements. The three types of communication shown in Figure 1-1 result from compilation, review, and audit engagements respectively. The present study places particular emphasis on two of these types of communication: compilation reports and review reports.

## CPA Association with Financial Statements

CPAs are associated with the financial statements of nonpublic businesses because of the demand for and value of the CPA's association. Four factors related to problems a user might face in dealing with the financial statements of a nonpublic business explain why users demand CPA association with them. These factors are conflict of interest, consequences, complexity, and remoteness. First, without independent CPA association with financial statements, the business might prepare biased statements to effect a favorable impression on users. A CPA

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[11]Ibid., p. 57.

can mitigate this possible conflict of interest. Second, if a third party makes an economically significant decision on the basis of information contained in the financial statements, then CPA assurances on the statements can reduce the risk of adverse consequences. Third, as the process which generates financial statements becomes more complex, users can rely on the CPA's technical proficiency. Finally, if users are physically or legally separated from financial statement preparers, then they can rely on the CPA's direct access to businesses.[12]

A CPA's association with financial statements is valuable to the user because he (1) controls the quality of information contained in the statements, and (2) enhances the credibility of the statements. First, a CPA controls the quality of accounting information by independently ascertaining that the information conforms to established accounting criteria. Knowing that a CPA will be associated with the statements motivates preparers to produce financial statements fairly. Second, a CPA enhances the credibility of financial statements because users perceive that the CPA controls the quality of accounting information.[13] Recent surveys confirm that users perceive the CPA's role as adding credibility to the reliability of financial statements.[14]

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[12]Ibid., pp. 25-26.

[13]Ibid., pp. 27-29.

[14]Alan J. Winters. "Unaudited Financial Statements: A Delineation of Issues, Survev of Practice, and Statement of Responsibility" (D.B.A. dissertation, Texas Tech University, 1974), p. 268 (hereafter cited as Winters, "Unaudited Financial Statements: A Delineation of Issues"); George A. Fiebelkorn, Jr., "The Role of the Certified Public Accountant in the Accounting Communication Process as Perceived by Sophisticated Users, With an Empirical Analysis of Factors Affecting Management Credibility and Certified Public Accountant Credibility" (Ph.D. dissertation, Georgia State University, 1977), p. 131 (hereafter cited as Fiebelkorn, "The Role of the Certified Public Accountant").

As a result of CPA association with financial statements, users believe that they can rely on the statements for decision making.

CPA Assurances on Financial Statements

The degree of CPA association with the financial statements of a nonpublic business relates to the level of assurance the CPA gives about the statements. This section examines two types of CPA assurances--achieved and expressed--for the various degrees of CPA association with financial statements: (1) no association, (2) a compilation engagement, (3) a review engagement, and (4) an audit engagement.

First, if a CPA is not associated with financial statements, then he can obviously neither achieve nor express any assurances about the statements.

Second, in a compilation engagement, the CPA can achieve minimum assurances about the financial statements, but cannot express any assurances about the statements. The CPA can achieve these assurances about the statements by reading the financial statements to consider whether such statements appear to be appropriate in form and free from material errors. In the compilation report, the CPA cannot express an opinion or any other form of assurance on the financial statements.[15] Thomas P. Kelley, an AICPA Managing Director (Technical), relates the Accounting and Review Services Committee's intentions with respect to achieved and expressed assurances about compiled financial statements:

> The committee did not intend to preclude accountants from achieving any assurance as to compiled financial statements..

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[15] ARSC, Compilation and Review of Financial Statements, pars. 13, 17.

. . But it did intend to preclude the expression of assurance in a compilation....[16]

Third, in a review engagement, the CPA both achieves and expresses limited assurances about the financial statements. A CPA achieves these assurances about the statements by reading the financial statements and performing analytical and inquiry procedures. In a review report, the CPA expresses limited assurances that he is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.[17]

Finally, in an audit engagement, the CPA both achieves and expresses reasonable assurances about the financial statements. The CPA achieves these assurances about the statements by performing review procedures, evaluating internal controls, and performing substantive and compliance tests. In an audit report, the CPA expresses reasonable assurances that the financial statements, taken as a whole, are fairly presented, and in conformity with generally accepted accounting principles applied on a consistent basis.[18]

## Meaning of the Reliability of Financial Statements

The form of assurance investigated in the present research is the reliability of financial statements. This section first reviews

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[16]Thomas P. Kelley, "Compilation and Review--A Revolution in Practice," CPA Journal, April 1979, p. 20 (hereafter cited as Kelley, "Compilation and Review").

[17]ARSC, Compilation and Review of Financial Statements, pars. 7, 35.

[18]AICPA, Statements on Auditing Standards: 1-38, secs. 150, 411.

the general meaning of reliability according to the accounting literature. Next, the difficulty in using a general meaning of reliability in the present study is discussed. Finally, a specific definition of reliability which is useful in the present study is proposed.

## General Meaning of Reliability in the Literature

The term "reliability" appears frequently in the accounting literature. Reliability usually refers to a qualitative standard or criterion by which CPAs and users of financial statements evaluate accounting information. References to reliability are found in publications of the American Accounting Association, the Accounting Principles Board, and the Financial Accounting Standards Board.

Two official releases of the American Accounting Association describe reliability. In A Statement of Basic Accounting Theory, the standard of verifiability contains a reference to reliability. The Statement finds that verifiability of accounting information enhances perceptions of the reliability of the information by persons who have neither access to the underlying records nor the ability to audit them.[19] In a later statement on accounting theory, Statement on Accounting Theory and Theory Acceptance, reliability denotes a quality which permits users to depend on data with confidence that it represents what it intends to represent.[20]

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[19] American Accounting Association, Committee To Prepare a Statement of Basic Accounting Theory, A Statement of Basic Accounting Theory (Sarasota, Florida: AAA, 1966), p. 10.

[20] American Accounting Association, Committee on Concepts and Standards for External Financial Reports, Statement on Accounting Theory and Theory Acceptance (Sarasota, Florida: AAA, 1977), p. 16.

In APB Statement Number 4, the Accounting Principles Board maintains that CPA association with financial statements enhances users' perceptions of financial statement reliability. As a result, third parties can rely on the statements for decision making.[21]

In an effort to establish a conceptual framework for financial accounting and reporting, the Financial Accounting Standards Board (FASB) develops a description of reliability. In Objectives of Financial Reporting by Business Enterprises, the FASB recognizes that CPAs audit financial statements to enhance confidence in the financial statements' reliability.[22] Later, in Qualitative Characteristics of Accounting Information, the FASB explains that accounting information is reliable to the extent that users can depend on the information to represent economic conditions or events.[23]

Based on the literature, reliability appears to be an important criterion by which users evaluate the credibility of financial statements. But the literature only describes reliability in an abstract manner; CPAs and users may not be able to apply such a general meaning of reliability to practical situations. In order to assess in the present research the extent to which CPAs and users perceive financial statements as reliable, a meaning of reliability which can be understood

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[21]APB Statement Number 4: Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises, reprinted in AICPA, Professional Standards: Accounting, Volume 3 (Chicago: Commerce Clearing House, Inc., 1975), secs. 1024.35, 1024.37.

[22]Financial Accounting Standards Board, Statement of Financial Accounting Concepts Number 1: Objectives of Financial Reporting by Business Enterprises (Stamford, Connecticut: FASB, 1978), par. 8.

[23]FASB, Qualitative Characteristics of Accounting Information, pars. 59, 62.

by both CPAs and users is necessary. The next section provides an aggregate definition of reliability.

Specific Meaning of Reliability

To avoid any confusion about the meaning of the term "reliability," a composite of reliability surrogates is used. The present research assumes that the financial statements of nonpublic businesses are reliable insofar as they are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of an existing material unintentional error, (4) free from the effects of an existing material management fraud, (5) free from the effects of an existing material employee fraud, and (6) evaluated by a CPA who is independent of management. Following a description of each of these reliability surrogates, AICPA standards pertaining to assurances about compilations and reviews and about audits are given.

In conformity with generally accepted accounting principles. Conformity with generally accepted accounting principles (GAAP) is a criterion by which CPAs and users evaluate the quality of accounting information. According to American Institute of Certified Public Accountants (AICPA) auditing standards, GAAP refer to the conventions, rules, and procedures which define accepted accounting practice at a particular time.[24]

Statement on Standards for Accounting and Review Services Number 1 (SSARS #1) states that compilation reports must not contain

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[24]AICPA, Statements on Auditing Standards: 1-38, sec. 411.02.

assurances about GAAP. However, SSARS #1 allows the CPA to achieve some assurances about GAAP. The CPA achieves these assurances by knowing about accounting principles in the industry of which the business is a part, and by reading the financial statements to consider whether the statements are appropriate in form and free from material errors. An error in this context may be a mistake in the application of an accounting principle.[25]

However, SSARS #1 requires that review reports contain limited assurances that the CPA is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with GAAP. With respect to GAAP, SSARS #1 allows the CPA to achieve limited assurances in two ways. The CPA achieves these assurances by reading the financial statements to consider whether the statements conform with GAAP and by asking the client's personnel whether the financial statements have been prepared in conformity with GAAP.[26]

Professional auditing standards state that audit reports contain reasonable assurances that financial statements conform to GAAP. The first standard of reporting in the section on generally accepted auditing standards (GAAS), is that the audit report should state whether the financial statements are presented in accordance with GAAP. AICPA auditing standards provide guidelines on how the CPA can achieve reasonable assurances about the conformity of financial statements with GAAP.[27]

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[25]ARSC, Compilation and Review of Financial Statements, pars. 10, 13.

[26]Ibid., par. 27.

[27]AICPA, Statements on Auditing Standards: 1-38, secs. 150.02, 411.

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Accompanied by all material disclosures. According to professional auditing standards, disclosures are: matters that relate to the form, arrangement, and content of the financial statements with their appended notes; terminology used; amount of detail given; classification of items in the statements; bases of amounts set forth; liens on assets; and contingent liabilities.[28]

SSARS #1 allows the CPA to compile financial statements which either omit or include substantially all disclosures. In the former case, the CPA disclaims responsibility for disclosures. The present research refers to compilations which include substantially all disclosures. In such reports, SSARS #1 requires that the CPA not express assurances about disclosures. However, this standard enables the CPA to achieve some assurances about disclosures. The CPA achieves these assurances by reading the statements to consider whether any mistakes in the application of accounting principles, including inadequate disclosures, have occurred.[29]

In review engagements, SSARS #1 requires that the CPA's review report contain limited assurances that he is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with GAAP. In this instance, GAAP comprehend the adequacy of disclosures. SSARS #1 allows the CPA to achieve limited assurances about disclosures by performing analytical and inquiry procedures to test the adequacy of disclosures.[30]

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[28]Ibid., sec. 430.02.

[29]ARSC, Compilation and Review of Financial Statements, pars. 13, 19-21.

[30]Ibid., par. 27.

Professional auditing standards state that audit reports contain reasonable assurances about the adequacy of disclosures. They also state that the fairness of financial statements in conformity with GAAP comprehends the adequacy of disclosures involving material matters. Further, based on the third standard of reporting in the section on GAAS, informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.[31] AICPA auditing standards provide guidelines on how the CPA can achieve reasonable assurances about disclosures in financial statements.

Free from the effects of an existing material unintentional error, management fraud, and employee fraud. One professional auditing standard defines errors as unintentional mistakes in financial statements, including clerical mistakes in underlying records and mistakes in the application of accounting principles. Management fraud is defined as an irregularity involving intentional distortions of financial statements, such as deliberate misrepresentations by management. The standard also defines employee fraud as an irregularity involving intentional distortions of financial statements, such as deliberate misrepresentations by employees. Both management fraud and employee fraud may result from misapplication of accounting principles and misappropriation of assets.[32]

With respect to errors, SSARS #1 permits the CPA to achieve some assurances in both compilation and review engagements. The CPA

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[31] AICPA, Statements on Auditing Standards: 1-38, secs. 430.02, 150.02.

[32] Ibid., secs. 327.02-.03.

achieves these assurances by reading financial statements to consider whether the statements are appropriate in form and free from material errors. In this context, an error refers to mistakes in the compilation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.[33] However, SSARS #1 recommends that the CPA's engagement letter regarding compilations and reviews establish an understanding with the client that the engagement cannot be relied on to disclose management fraud or employee fraud.[34]

The professional auditing standard which defines errors and fraud also states that audit reports contain reasonable assurances that financial statements are not materially misstated because of errors, management fraud, or employee fraud. The CPA achieves these assurances by planning and carrying out audits to search for errors and irregularities that would have a material effect on the financial statements.[35]

Evaluated by a CPA who is independent of management. Users rely on CPA independence to neutralize conflicts of interest between financial statement preparers and users. The AICPA's Code of Professional Ethics views independence as the cornerstone of its philosophical structure. Opinions by CPAs may be of little value to third parties

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[33]ARSC, Compilation and Review of Financial Statements, par. 13.

[34]Ibid., par. 8.

[35]AICPA, Statements on Auditing Standards: 1-38, secs. 327.04-.05.

unless independence is maintained.[36]

With respect to compilation engagements, SSARS #1 provides that CPAs may or may not be independent. When the CPA is not independent, he must state that in the compilation report.[37] The present research refers to compilation engagements in which the CPA is independent.

SSARS #1 requires that CPAs be independent in review engagements.[38] Furthermore, Interpretation 101-3 of the Code of Ethics provides guidelines on how CPAs are to achieve independence with respect to compilations and reviews. These guidelines follow:

1. CPAs must not have any relationships or conflicts of interest with clients which would impair integrity or objectivity.

2. Clients must accept responsibility for the financial statements. Small clients may rely on CPAs to maintain accounting records.

3. CPAs must not assume the role of employees or management in conducting enterprise operations.

4. CPAs must conform to GAAS when examining CPA-maintained financial records or statements.[39]

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[36]American Institute of Certified Public Accountants, Code of Professional Ethics, reprinted in AICPA, Professional Standards, Volume 2 (Chicago: Commerce Clearing House, Inc., 1979), p. 4291 (hereafter cited as AICPA, Code of Professional Ethics).

[37]ARSC, Compilation and Review of Financial Statements, par. 22.

[38]Ibid., par. 38.

[39]AICPA, Code of Professional Ethics, pp. 4412 - 4414.

Finally, professional auditing standards require that CPAs be independent in audits. Independence recognizes the obligation of fairness to third parties who rely on CPA assurances. Further, based on the second general standard in the section on GAAS, independence in mental attitude is to be maintained by the CPA.[40]

Need for Research about the CPA-User Communication Process

The present research is needed for two reasons. First, there has been a history of confusion about unaudited financial statements. Second, even though the accounting profession has responded to this confusion by issuing new standards, the potential for similar problems with compilations and reviews still exists.

A model is useful in representing the CPA-user communication process within the framework of financial reporting for nonpublic businesses. Figure 1-2, adapted from Libby,[41] depicts this process. The first link in the diagram refers to similarities between CPAs' and users' perceptions of assurances about the reliability of financial statements. The second link indicates that the user's perception of the CPA's assurances determines the user's reaction to the assurances as perceived. Finally, in the third link, the user makes a decision based on his perception of and reaction to the CPA's intended assurances. Obviously, if the user misperceives the CPA's intended assurances, he may make decisions on a faulty basis. On the other hand,

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[40]AICPA, Statements on Auditing Standards: 1-38, secs. 150.02, 220.02.

[41]Robert Libby, "Bankers' and Auditors' Perceptions of the Message Communicated by the Audit Report," Journal of Accounting Research, Spring 1979, p. 100 (hereafter cited as Libby, "Bankers' and Auditors' Perceptions").

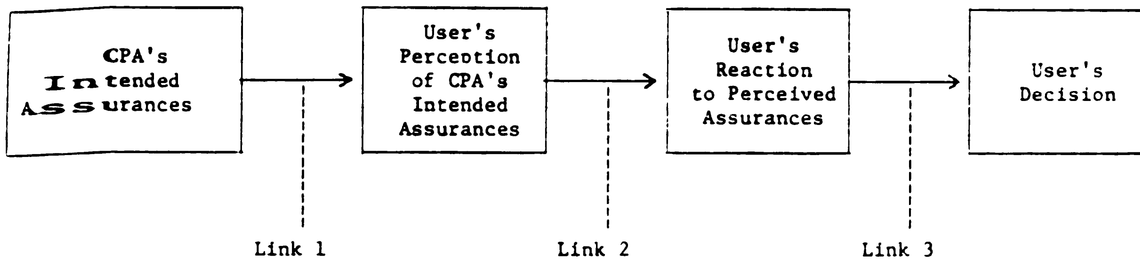


Fig. 1-2. CPA-User communication process

when the user correctly perceives the CPA's intended assurances, valid decisions are more likely to be made.

Because communication involves shared perceptions, it can be assumed that the communication process is effective when CPAs and users share similar perceptions of the reliability of financial statements. Ideally, the user would perceive the same level of assurance about the financial statements as the CPA. Past experience has shown, however, that CPAs and users differ in their perceptions of reliability. Furthermore, there is reason to believe that these differences of perception may still exist. This section first reviews the problems historically related to communication from CPAs to users about unaudited financial statements. Then, potential problems in the CPA-user communication process with respect to compilations and reviews are described.

## Problems with Unaudited Financial Statements

Before the development of compilations and reviews, a CPA was associated with either unaudited or audited financial statements of a nonpublic business. When associated with unaudited financial statements, the CPA either did not apply auditing procedures to the statements or did not apply auditing procedures sufficient to permit the expression of an audit report. The CPA reported on unaudited financial statements by issuing an opinion disclaimer, in which he did not express any assurances about the reliability of the statements.[42] Association with unaudited financial statements produced two major problems, one investigative and one communicative. After examining the nature of the investigative problem, the communicative problem is described.

An investigative problem of association with unaudited financial statements was that CPAs were uncertain about the extent of auditing procedures to perform on them. Two factors, litigation and recommendations made by accounting academicians and practitioners, contributed to this uncertainty. First, several legal cases, which will be discussed in detail in Chapter III, encouraged CPAs to adopt one of two approaches concerning the extent of auditing procedures to perform on unaudited financial statements. Some CPAs believed that performing limited auditing procedures on unaudited financial statements would provide clients with a satisfactory level of service and preclude the CPA's association with substandard statements. This approach risked that users and the courts would attribute audit-type assurances to the reliability of the statements.[43] In recognition of this approach, two

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[42] American Institute of Certified Public Accountants, Codification of Statements on Auditing Standards: Numbers 1 to 15 (Chicago: Commerce Clearing House, Inc., 1977), secs. 516.01-.04 (hereafter cited as AICPA, Codification of Statements on Auditing Standards: 1-15).

[43] Junius Terrell, "Minimum Standards for Unaudited Financial Statements," Journal of Accountancy, May 1973, p. 58 (hereafter cited as Terrell, "Minimum Standards"); Dan M. Guy and Alan J. Winters, "Unaudited Financial Statements: A Survey," Journal of Accountancy, December 1972, p. 51 (hereafter cited as Guy and Winters, "Unaudited Financial Statements").

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surveys indicated that many CPAs performed limited auditing procedures on unaudited financial statements, and that many users perceived that CPAs performed these procedures.[44] Other CPAs believed that no auditing procedures should be performed on unaudited statements to prevent users and the courts from perceiving audit-type assurances about the reliability of the statements. Holders of this view contended that users and the courts would attribute audit-type assurances to the statements merely because a CPA was associated with the statements.[45]

Second, many accounting academicians and practitioners, whose articles will be cited in Chapter IV, contributed to CPAs' uncertainties by proposing new auditing standards. They recommended that the accounting profession issue guidelines with respect to limited auditing procedures to be performed on unaudited financial statements. These recommended guidelines would standardize limited procedure engagements and enable CPAs to express limited assurances about the reliability of the statements.

Eventually, a communicative problem emerged: it was not clear to what extent users attributed to the CPA's opinion disclaimer assurances about the reliability of the statements. If the CPA performed limited auditing procedures on the financial statements, then he might achieve some assurances about the reliability of the statements

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[44]Alan J. Winters, "Banker Perceptions of Unaudited Financial Statements," CPA Journal, August 1975, p. 32 (hereafter cited as Winters, "Banker Perceptions"); Guy and Winters, "Unaudited Financial Statements," p. 51.

[45]Robert H. Saunders, Jr., "Procedures In Minimizing Risk When Associated With Unaudited Financial Statements," Connecticut CPA, March 1973, p. 26 (hereafter cited as Saunders, "Procedures In Minimizing Risk"); Guy and Winters, "Unaudited Financial Statements," p. 51.

without expressing such assurances. In addition, users might attribute reliability to the statements, even though the CPA gave no assurances about their reliability.

In light of the confusion among CPAs about what auditing procedures they should perform and the possible misperceptions of CPA assurances by users, the AICPA responded by issuing SSARS #1. Applying to nonpublic businesses only, SSARS #1 replaced CPA association with unaudited financial statements and the accompanying opinion disclaimer report with two types of engagements and reports--compilation and review. However, in spite of this response, the possibility still remains that users may misperceive assurances about the reliability of financial statements which are accompanied by compilation reports or review reports.

## Potential Problems with Compilations and Reviews

The focus of the present research is the first link in the CPA-user communication process shown in Figure 1-2. The major issue is whether that link is functioning effectively. As stated before, if this communication process is to be considered effective, CPAs' and users' perceptions of intended assurances about the reliability of financial statements should be similar. Furthermore, within the context of the present professional standards, CPAs should be able to perceive the differences between the reliability of (1) financial statements which are not accompanied by any CPA report, (2) statements which are accompanied by the CPA's compilation report, (3) statements which are accompanied by the CPA's review report, and (4) statements which are accompanied by the CPA's audit report. Users must also perceive these differences in order to effectively make decisions.

Based on past problems with unaudited financial statements, it is reasonable to conjecture that communication problems with compilations and reviews, which replaced unaudited statements, exist. First, it may be the case that users do not perceive differences in reliability among statements accompanied by compilation, review, and audit reports. Thus, they may believe that CPAs are expressing audit-type assurances for each report. Winters notes that such unwarranted perceptions of the reliability of unaudited financial statements may be caused by either inadequate communication from CPAs to users, or philosophical differences between CPAs and users.[46] Second, it is possible that users do not have the accounting expertise with which to differentiate between the various reports and assurances about reliability. For example, users may be confused about the differences between compilations and reviews. Also, they may not understand the nature of CPA procedures performed during each type of CPA engagement.

Therefore, research is needed to determine the effectiveness of the CPA-user communication process, particularly with respect to the reliability of financial statements. If users misperceive intended assurances about the reliability of financial statements, their economic decision making could be jeopardized.

## Objectives of the Study

The primary objective of the study is to provide empirical information which will answer the following six research questions and the corresponding hypotheses. Figure 1-3 depicts this objective.

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[46] Winters, "Unaudited Financial Statements: A Delineation of Issues," pp. 116-118.

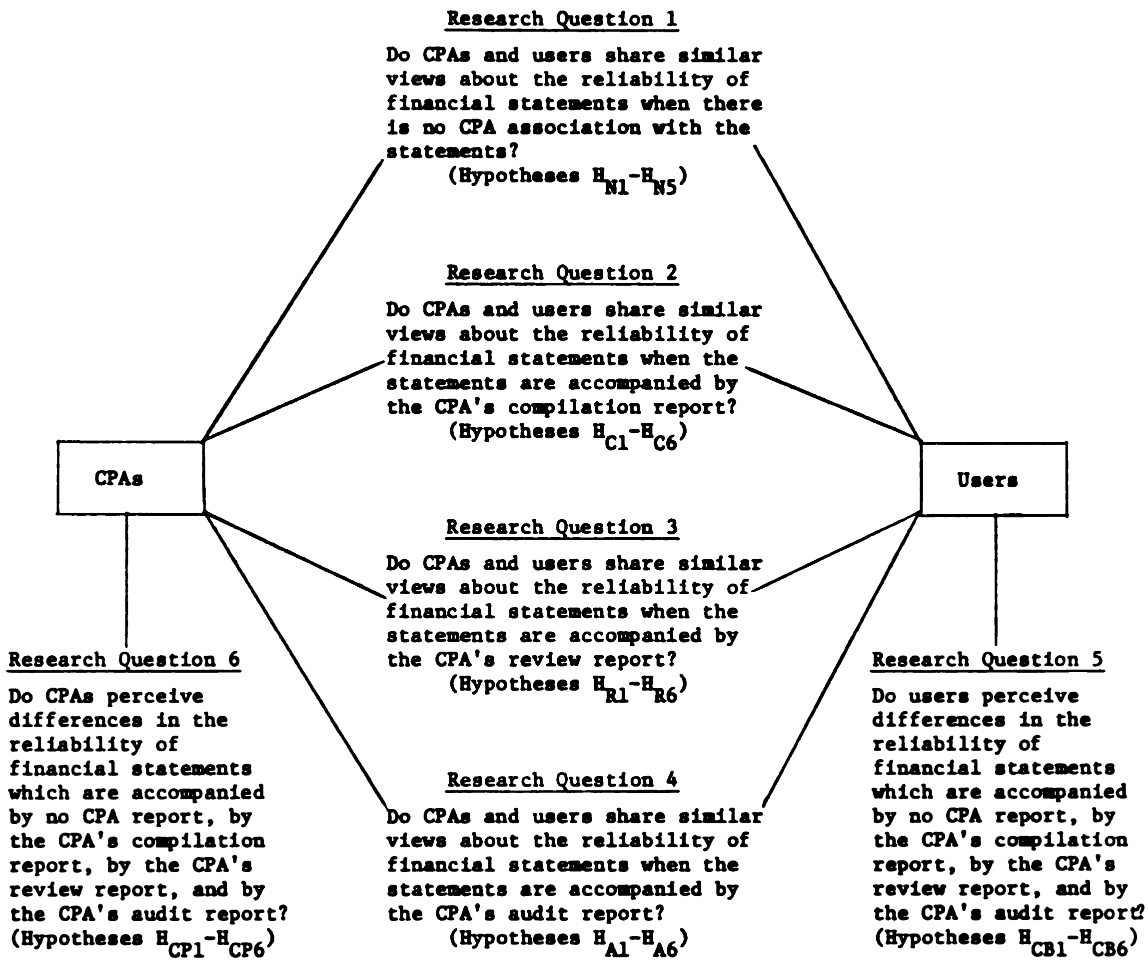


Fig. 1-3. Research questions and hypotheses

Research Question Number 1: Do CPAs and users share similar views about the reliability of financial statements when there is no CPA association with the statements?

Hypotheses $H_{N1}$-$H_{N5}$: When there is no CPA association with the financial statements, CPAs and bankers share similar views that the statements are:

$H_{N1}$: in conformity with generally accepted accounting principles.

$H_{N2}$: accompanied by all material disclosures.

$H_{N3}$: free from the effects of an existing material unintentional error.

$H_{N4}$: free from the effects of an existing material management fraud.

$H_{N5}$: free from the effects of an existing material employee fraud.

Research Question Number 2: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's compilation report?

Hypotheses $H_{C1}$-$H_{C6}$: When the financial statements are accompanied by the CPA's compilation report, CPAs and bankers share similar views that the statements are:

$H_{C1}$: in conformity with generally accepted accounting principles.

$H_{C2}$: accompanied by all material disclosures.

$H_{C3}$: free from the effects of an existing material unintentional error.

$H_{C4}$: free from the effects of an existing material management fraud.

$H_{C5}$: free from the effects of an existing material employee fraud.

$H_{C6}$: evaluated by a CPA who is independent of management.

Research Question Number 3: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's review report?

Hypotheses $H_{R1}$-$H_{R6}$: When the financial statements are accompanied by the CPA's review report, CPAs and bankers share similar views that the statements are:

$H_{R1}$: in conformity with generally accepted accounting principles.

$H_{R2}$: accompanied by all material disclosures.

$H_{R3}$: free from the effects of an existing material unintentional error.

$H_{R4}$: free from the effects of an existing material management fraud.

$H_{R5}$: free from the effects of an existing material employee fraud.

$H_{R6}$: evaluated by a CPA who is independent of management.

Research Question Number 4: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's audit report?

Hypotheses $H_{A1}$-$H_{A6}$: When the financial statements are accompanied by the CPA's audit report, CPAs and bankers share similar views that the statements are:

$H_{A1}$: in conformity with generally accepted accounting principles.

$H_{A2}$: accompanied by all material disclosures.

$H_{A3}$: free from the effects of an existing material unintentional error.

$H_{A4}$: free from the effects of an existing material management fraud.

$H_{A5}$: free from the effects of an existing material employee fraud.

$H_{A6}$: evaluated by a CPA who is independent of management.

Research Question Number 5: Do users perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Hypotheses $H_{CB1}$-$H_{CB5}$: When the financial statements are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, bankers perceive that the statements are equally:

$H_{CB1}$: in conformity with generally accepted accounting principles.

$H_{CB2}$: accompanied by all material disclosures.

$H_{CB3}$: free from the effects of an existing material unintentional error.

$H_{CB4}$: free from the effects of an existing material management fraud.

$H_{CB5}$: free from the effects of an existing material employee fraud.

Hypothesis $H_{CB6}$: When the financial statements are accompanied by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, bankers perceive that the statements are equally:

$H_{CB6}$: evaluated by a CPA who is independent of management.

Research Question Number 6: Do CPAs perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Hypotheses $H_{CP1}$-$H_{CP5}$: When the financial statements are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, CPAs perceive that the statements are equally:

$H_{CP1}$: in conformity with generally accepted accounting principles.

$H_{CP2}$: accompanied by all material disclosures.

$H_{CP3}$: free from the effects of an existing material unintentional error.

$H_{CP4}$: free from the effects of an existing material management fraud.

$H_{CP5}$: free from the effects of an existing material employee fraud.

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Hypothesis $H_{CP6}$: When the financial statements are accompanied by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, CPAs perceive that the statements are equally:

$H_{CP6}$: evaluated by a CPA who is independent of management.

A secondary objective of the present study is to assess the extent to which CPAs and users perceive different levels of confidence among the reliability surrogates for each degree of CPA association. For example, when the financial statements are accompanied by the CPA's review report, which of the six reliability surrogates do bankers rate the highest in terms of confidence in the financial statements? Another secondary objective is to assess the extent to which CPAs and users are familiar with compilations and reviews.

## Research Methodology

### Sample Selection

To accomplish the objectives of the study, questionnaires were mailed to 200 Michigan practicing bankers and to 200 Michigan practicing CPAs. The sample of bankers was comprised of 130 commercial bank loan officers (CBLOs) from large banks (the total assets of which were greater than $100 million per bank) and 70 chief executive officers (CEOs) from small banks (the total assets of which were less than $100 million per bank).[47] CBLOs were randomly selected from the following two sampling frames: Robert Morris Associates' 1979-1980 Membership Directory and names of CBLOs provided by individual banks. CEOs were randomly selected from Michigan National Corporation's 1979 Michigan

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[47] In some cases other bankers replied on behalf of the targeted CBLOs and CEOs.

Bank Directory. CPAs were randomly selected from the Michigan Association of Certified Public Accountants' 1979 Membership Directory.

## The Questionnaire

The questionnaire presented a hypothetical loan situation (involving a CPA, the financial statements of a nonpublic business, and a banker) which provided respondents with a common frame of reference. Hypothetical CPA reports (compilation, review, and unqualified audit) depicted increasing levels of assurance about the financial statements of the business, based on increasing degrees of CPA association. CPAs, CBLOs, and CEOs rated the six reliability surrogates for the financial statements accompanied by each of the three types of CPA reports. CPAs, CBLOs, and CEOs also rated five reliability surrogates (excluding CPA independence) for the condition of no CPA report (no association with financial statements). Respondents' perceptions of reliability were measured on a seven-point numerical rating scale with values assigned which ranged from "0" (no confidence) to "6" (complete confidence).

The questionnaire also presented six compilation and review familiarity questions, demographic questions, and space for written comments.

## Statistical Analyses

Parametric multivariate repeated measures F-tests and univariate t-tests were used to test the research hypotheses. Univariate t-tests were also used to assess the respondents' relative confidence placed in the reliability surrogates for each degree of association. Finally, sample percentages were used to describe the extent to which respondents were familiar with compilations and reviews.

## Contributions

The present research provides empirical information about the CPA-user communication process within the framework of financial reporting for nonpublic businesses. More specifically, the research provides information about the effects of compilation and review reports on CPAs' and bankers' perceptions of the reliability of financial statements. Besides accomplishing the primary and secondary objectives stated previously, the information gathered through this study can help answer two related questions about compilations and reviews. One is, Do users attribute audit-type assurances to compilation or review reports? The other is, Do CPAs and users understand that CPAs provide increasing levels of assurance about the reliability of financial statements as the statements are accompanied, in order, by compilation reports, by review reports, and by audit reports?

## Summary

This chapter introduced the present study with an overview of the subject area, an outline of the organization of the thesis, and definitions of terms. This chapter also described the financial reporting framework in which CPAs perform engagements for nonpublic businesses. The types of CPA association with financial statements and their corresponding reports, including the levels of assurance provided by each report, were presented also.

The chapter went on to describe the form of assurance investigated in the present study, namely, reliability. In this section, an aggregate definition of reliability made up of six surrogates was specified for the purposes of this study. The next four subsections described how accounting standards enable CPAs to provide assurances about each of these reliability surrogates.

Next, this chapter discussed the need for the present research by referring to past problems with CPA-user communication regarding unaudited financial statements. It then discussed the potential for similar problems with compilations and reviews.

Then, the chapter presented the objectives of the present study by listing the research questions and corresponding research hypotheses. A brief description of the methodology used to accomplish these objectives followed. Finally, the last section of the introduction described contributions of the present study.

The next chapter reviews previous studies which are similar in scope to the present research.

## CHAPTER II

## REVIEW OF PREVIOUS RESEARCH

The purpose of this chapter is to review previous studies which are similar in scope to the present research. Each study is reviewed in three parts: (1) a description of the study, (2) its major findings and conclusions, and (3) how its major findings relate to the present research. Following this review, the findings and limitations of the previous research are summarized. The final section of this chapter discusses how the present research improves upon the limitations of these prior studies.

### Guy, Greenway, Miller, and Mills

#### Description of the Study

Guy, Greenway, Miller, and Mills investigated whether financial statement users understand the relationship between financial statement credibility and the extent of responsibilities assumed by a reporting CPA.[1] In addressing this question, the researchers examined CBLOs' perceptions of the reliability of annual financial statements based on a set of CPA-graded opinions.

The researchers mailed questionnaires to all Texas members of Robert Morris Associates. Questionnaires were returned by 159 CBLOs

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[1] Dan M. Guy, Roy M. Greenway, Ross M. Miller, and John C. Mills, "Audit Reports, Financial Statements and Creditor Perceptions," Texas CPA, January 1974, pp. 5-10.

(41% response rate).

The questionnaire mailed to CBLOs depicted a group of hypothetical CPA reports to depict various audit opinions. These reports were: unqualified audit; divided responsibility audit; audit qualified by an inconsistency: audit qualified by omission of a statement of changes in financial position; audit qualified by a material uncertainty; audit qualified by an exception to generally accepted accounting principles; adverse; and opinion disclaimer with respect to unaudited financial statements. In addition, following each report the questionnaire contained a ten-point rating scale on which respondents rated the extent to which they would rely on financial statements accompanied by these various CPA reports. The researchers analyzed the data by using descriptive parametric statistics.

Major Findings and Conclusions

Guy et al. reported two major findings and related conclusions about the research. Their first finding was that CBLOs did not adequately perceive differences among qualified, adverse, and opinion disclaimer reports. With respect to these reports, the researchers concluded that financial statement users (CBLOs) did not understand the relationship between financial statement credibility and the extent of responsibilities assumed by a CPA. Second, they found that CBLOs did believe that financial statements accompanied by an unqualified audit report were more reliable than financial statements accompanied by any one of the other reports. With respect to the unqualified audit report, the researchers concluded that financial statement users (CBLOs) did understand the relationship between financial statement credibility and the extent of responsibilities assumed by a CPA.

### Major Findings Related to the Present Research

Like the present research, Guy et al. examined whether CBLOs perceived different assurances about the reliability of financial statements among different types of reports. The results indicate that CBLOs perceived different assurances about reliability between opinion disclaimer reports and audit reports. When applied to the present study, these results suggest that CBLOs may perceive differences in reliability (1) between compilations and audits and (2) between reviews and audits.

## Winters

### Description of the Study

Winters investigated the nature of CPA responsibilities for unaudited financial statements.[2] As part of this investigation, he examined CPAs' and CBLOs' perceptions of the reliability of unaudited financial statements.

Winters mailed questionnaires to randomly selected AICPA practitioners and CBLOs located throughout the United States. Questionnaires were returned by 375 CPAs (31% response rate) and 570 CBLOs (48% response rate).

The questionnaire mailed to CPAs contained two questions relevant to the reliability of financial statements. These were:

1. Do you believe that bankers, as a specific group of users, place more confidence in unaudited statements, if a CPA is associated with the statements?

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[2] Winters, "Unaudited Financial Statements: A Delineation of Issues."

2. To what extent do you feel that your association, as a CPA, with unaudited financial statements affects third party users' confidence that the statements are prepared in conformity with generally accepted accounting principles and are not false or misleading?

Following the first question, the questionnaire contained a two-point rating scale on which respondents either agreed or disagreed. Following the second question, the questionnaire contained a five-point rating scale on which respondents rated the extent of increase in confidence due to CPA association.

The questionnaire mailed to CBLOs contained two questions and an assertion relevant to the reliability of financial statements. These were:

1. To what extent do you feel that a CPA's association with unaudited financial statements affects the degree of reliability you place in such statements?

2. To what extent do you feel that a CPA's association with unaudited financial statements affects the likelihood that the statements are prepared in conformity with generally accepted accounting principles?

3. Although the CPA does not perform an audit when he is associated with unaudited financial statements, and, therefore, cannot express an opinion on the statements, the professional integrity of the CPA provides a reasonably high assurance that the unaudited financial statements will not be false or misleading.

Following the first two questions, the questionnaire contained five-point rating scales on which respondents rated the extent of increase in reliability due to CPA association (first question) and the extent of increase in likelihood due to CPA association (second question). Following the assertion, the questionnaire contained a five-point rating scale on which respondents rated the extent of their agreement with the assertion. Winters described both CPA and CBLO responses by using sample percentages.

Major Findings and Conclusions

Winters reported findings and conclusions about both CPA and CBLO responses. With respect to CPA responses, Winters found that:

1. Most of the respondents (94%) agreed that bankers place more confidence in unaudited financial statements if a CPA is associated with the statements.

2. Most of the respondents (89%) perceived that CPA association with unaudited financial statements increases users' confidence that the statements are not false or misleading and are prepared in conformity with generally accepted accounting principles.

Winters concluded that most CPAs believed that their association with unaudited financial statements increases users' confidence in the statements.

With respect to CBLO responses, Winters found that:

1. Most of the respondents (78%) perceived that CPA association with unaudited financial statements increases the degree of reliability they place in the statements.

2. Most of the respondents (86%) believed that CPA association with unaudited financial statements increases the likelihood that the statements are prepared in conformity with generally accepted accounting principles.

3. A majority of the respondents (58%) agreed that CPA association with unaudited financial statements provides assurance that the statements are not false or misleading.

Winters concluded that a majority of CBLOs attributed increased credibility to unaudited financial statements as a result of CPA association.

## Major Findings Related to the Present Research

Winters' study was similar to the present research because he investigated both CPAs' and CBLOs' perceptions of the reliability of unaudited financial statements for three reliability surrogates. These surrogates were: the financial statements are reliable, the financial statements are not false or misleading, and the financial statements are in conformity with generally accepted accounting principles. Although Winters did not statistically compare the perceptions of CPAs to CBLOs, he did find that both groups perceive different assurances about the reliability of financial statements with which a CPA has not been associated and unaudited financial statements with which a CPA has been associated. When applied to the present study, these results suggest that CPAs and CBLOs may perceive differences in reliability (1) between financial statements which are not accompanied by a CPA report and financial statements which are accompanied by a CPA's compilation report, and (2) between financial statements which are not accompanied by a CPA report and financial statements which are accompanied by a CPA's review report.

## Fiebelkorn

## Description of the Study

Fiebelkorn investigated financial statement users' perceptions of the CPA's role in the CPA-user communication process.[3] As part of this investigation, he examined the attitudes of different user groups toward the reliability of financial statements based on different

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[3]Fiebelkorn, "The Role of the Certified Public Accountant."

degrees of CPA association with the statements.

Fiebelkorn mailed questionnaires to four user groups. Questionnaires were returned by forty-seven bank loan officers, ninety-two bank trust officers, fifty-nine insurance investment officers, and thirty-four investment counselors (response rates were 62%, 50%, 62%, and 45% respectively). The subjects in each group were randomly selected from large national organizations.

The questionnaire mailed to the user groups contained three questions relevant to the users' reliance on financial statements. These were:

1. How much concern or worry does the complete absence of a CPA's association with a particular set of financial statements have on your reliance on the statements?

2. How much influence does the presence of only an association by a CPA (no opinion is rendered) with a particular set of financial statements have on your reliance on the statements?

3. How much influence does the presence of a CPA's opinion on a particular set of financial statements have on your reliance on the statements?

Following the questions, the questionnaire contained nine-point rating scales on which respondents rated the extent of their concern about reliance (first question) and the amount of influence on their reliance (second and third questions). Fiebelkorn analyzed the data by using descriptive statistics and by testing hypotheses with respect to median rating scores.

## Major Findings and Conclusions

Based on a composite of user groups' responses, Fiebelkorn found that:

1. Users believed that the absence of CPA association with financial statements causes them considerable concern about relying on the statements.

2. Users perceived that CPA association with unaudited financial statements influences reliance, but is not vital to reliance.

3. Users believed that the presence of the CPA's audit opinion on financial statements is vital to reliance.

Fiebelkorn concluded that the presence of a CPA's opinion on financial statements is vital to users' reliance. Further, users perceived that the extent of reliance increases as the degree of the CPA's association with the financial statements increases.

### Major Findings Related to the Present Research

Fiebelkorn's research is comparable to the present study because he examined the reliance users place on financial statements prepared with different degrees of CPA association. The results indicated that the users placed varying amounts of reliance on statements prepared under the conditions of no CPA association with financial statements, CPA association with unaudited financial statements, and audits. When applied to the present study, these results suggest that users may perceive differences in reliability of financial statements prepared (1) under the conditions of no CPA association with financial statements, compilations, and audits and (2) under the conditions of no CPA association with financial statements, reviews, and audits.

## Bainbridge

### Description of the Study

Bainbridge investigated the CPA's ability to detect management fraud when associated with small business financial statements.[4] In investigating this subject, he examined CPAs' and CBLOs' perceptions of various aspects of the CPA's ability to detect management fraud.

Bainbridge mailed questionnaires to randomly selected CPAs and CBLOs in Pennsylvania. Questionnaires were returned by 121 CPAs (43% response rate) and 120 CBLOs (40% response rate).

The primary section of the questionnaire contained a number of assumptions and factors which represented various aspects of the CPA's ability to detect management fraud. These items were separately listed for CPA association with unaudited financial statements and with audited financial statements. Following the items, the questionnaire contained six-point rating scales on which both CPAs and CBLOs rated either the extent of agreement with each item or the degree of importance of each item. Bainbridge used nonparametric Kolmogorov-Smirnov statistics to test hypotheses about the data.

A secondary section of the questionnaire contained two assertions relevant to the reliability of financial statements. These were:

1. The unaudited financial statements prepared by an owner-manager or his employees are as reliable as the unaudited financial statements with which a CPA has been associated.

2. Unaudited financial statements are as reliable as audited financial statements if a CPA has been associated with the unaudited financial statements.

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[4]Dunham R. Bainbridge, "Perceptions of the CPA's Ability to Detect Misrepresentations of the Smaller Business's Financial Statements" (Ph.D. dissertation, Lehigh University, 1978).

Following each assertion, the questionnaire contained six-point rating scales on which CPA and CBLO respondents rated the extent of their agreement with each assertion. Bainbridge described the data on responses to these two assertions by using sample percentages.

## Major Findings and Conclusions

Bainbridge reported findings and conclusions about both sections of the questionnaire. First, with respect to the CPA's ability to detect management fraud, Bainbridge found that:

1. CPAs and CBLOs did not share similar views about the accuracy of various assumptions which may affect the CPA's ability to detect management fraud when preparing small business financial statements. Instances of disagreement included the extent to which CPAs rely on inquiry and the extent to which CPAs perform analytical procedures.

2. CPAs and CBLOs generally shared similar views about the accuracy of various assumptions which may affect the CPA's ability to detect management fraud when auditing small business financial statements.

Second, with respect to the two assertions about the reliability of financial statements, Bainbridge found that:

1. Approximately 80% of the CPA and CBLO respondents believed that unaudited financial statements prepared by an owner-manager or employees were not as reliable as unaudited financial statements with which CPAs are associated.

2. Approximately 90% of the CPA and CBLO respondents believed that unaudited financial statements with which CPAs are

associated were not as reliable as audited financial statements.

## Major Findings Related to the Present Research

Bainbridge's study was similar to the present research because he compared the extent to which CPAs' and CBLOs' perceptions of the reliability of financial statements were similar. Also, like the present study, he investigated whether CPAs and CBLOs have similar perceptions of the reliability of financial statements based on different degrees of CPA association.

With respect to the CPA's ability to detect management fraud as a reliability surrogate, Bainbridge found that the type of CPA association with financial statements appears to affect the comparison of CPA and CBLO perceptions. Given CPA association with unaudited financial statements, CPAs and CBLOs did not share similar views about the accuracy of various assumptions which may affect the CPA's ability to detect management fraud. However, given CPA association with audited financial statements, CPAs and CBLOs did share similar views about the accuracy of those same assumptions. When applied to the present study, these results suggest that CPA and CBLO perceptions of the reliability of financial statements may not be similar for compilations and may not be similar for reviews. Furthermore, the results suggest that CPA and CBLO perceptions of the reliability of financial statements may be similar for audits.

Bainbridge also found that CPAs and CBLOs have different perceptions of the reliability of statements under the conditions of no CPA association with financial statements, CPA association with unaudited financial statements, and audits. When applied to the present research, these results suggest that CPAs and CBLOs may perceive differences in the reliability of statements (1) under the conditions of no CPA association with financial statements, compilations, and audits; and (2) under the conditions of no CPA association with financial statements, reviews, and audits.

## Pany

### Description of the Study

Pany investigated whether different types of CPA association with quarterly income information affects users' perceptions of the reliability of the information.[5] As part of this investigation, he examined questionnaire responses from fifty-seven financial analysts. Pany nonrandomly selected these analysts from five large commercial banks located in a large Midwestern city.

Pany used four questionnaire forms in this field experiment. Each form contained a different degree of CPA association with quarterly income information. These were: (1) no CPA association with the quarterly income information; (2) a limited review conducted at year end, reported by a footnote in the annual financial statements; (3) a limited review conducted at the end of the quarter, reported by an opinion disclaimer at the end of the quarter; and (4) an audit conducted at the end of the quarter, reported by a short form audit report at the end of the quarter. Following each condition, the questionnaire contained an eleven-point rating scale on which respondents rated their degree of confidence that the quarterly information

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[5]Kurt J. Pany, "Quarterly Financial Reporting: A Test of Varying Forms of Auditor Association" (Ph.D. dissertation, University of Illinois at Urbana-Champaign, 1978).

was free from accounting errors. Pany analyzed the data by using parametric F-tests and multiple comparisons to test hypotheses about the mean scores.

## Major Findings and Conclusions

Pany found that the financial analyst respondents attributed greater reliability to the income information as the conditions of CPA association progressed from no CPA association to year-end limited review to quarterly limited review to quarterly audit. Pany added another dimension to his study by specifying the inaccuracy or accuracy of the client's past financial information. If Pany specified that the client's past financial information was inaccurate, he found that:

1. Users attributed significantly more reliability to the financial information under the condition of a quarterly audit than to information under the condition of a year-end limited review.

2. Users attributed significantly more reliability to the financial information under the condition of a quarterly audit than to information under the condition of no CPA association.

3. Users attributed significantly more reliability to the financial information under the condition of a quarterly limited review than to information under the condition of no CPA association.

4. Users attributed significantly more reliability to the financial information under the condition of a year-end limited review than to information under the condition of no CPA association.

If Pany specified that the client's past financial information was accurate, he found that respondents perceived no significant differences in the reliability of the financial information produced under the four conditions. As a result of this research, Pany concluded that respondents perceived an effect on the reliability of quarterly income information according to the degree of CPA association with the information. Further, he noted that the often stated fear of CPAs, that users do not understand the limitations of audits, was not substantiated by the results of this study.

## Major Findings Related to the Present Research

Pany's research is comparable to the present study in that it examined whether users perceived different assurances about the reliability of financial information based on different degrees of CPA association. The results indicated that the financial analysts perceived (1) differences in reliability between quarterly income information under the conditions of no CPA association and the CPA's limited review, (2) differences in reliability between quarterly income information under the conditions of no CPA association and the CPA's quarterly audit, and (3) no differences in reliability between quarterly income information under the conditions of the CPA's limited review and the CPA's quarterly audit. When applied to the present study, these results suggest that users may perceive (1) differences in reliability between financial statements under the conditions of no CPA association and the CPA's review, (2) differences in reliability between financial statements under the conditions of no CPA association and the CPA's audit, and (3) no differences in reliability between financial statements under the conditions of the CPA's review and the CPA's audit.

## Libby

### Description of the Study

Libby investigated whether messages which CPAs intend to convey by audit reports are consistent with financial statement users' perceptions of these messages.[6] In addressing this question, he compared CPAs' and CBLOs' perceptions of the reliability of financial statements based on different types of audit reports.

Libby nonrandomly selected thirty CPAs and twenty-eight CBLOs to complete questionnaires in a laboratory setting. The CPAs were audit partners from five international public accounting firms. The CBLOs were senior officers from five large Chicago banks.

The questionnaire completed by the CPAs and CBLOs used hypothetical CPA reports to depict various audit opinions. These reports were: unqualified audit; audit qualified by an uncertainty about asset realization; audit qualified by an uncertainty about litigation; audit qualified by a circumstance-imposed scope limitation; audit qualified by a client-imposed scope limitation; audit disclaimed by an uncertainty about asset realization; audit disclaimed by an uncertainty about litigation; audit disclaimed by a circumstance-imposed scope limitation; audit disclaimed by a client-imposed scope limitation; and opinion disclaimer with respect to unaudited financial statements.

The questionnaire was divided into two sections, which contained two different types of rating scales. The first section followed each report with thirteen ten-point rating scales. Three

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[6] Libby, "Bankers' and Auditors' Perceptions."

of the scales relevant to the reliability of financial statements were:

1. Reliability or verifiability of the financial statement data (Statements of Financial Position, Earnings, and Changes in Financial Position).

2. Degree to which financial statement users must rely on the auditor's judgment to estimate the effects of the information in the report.

3. How heavily the financial statement data can be relied upon in decisions (the usefulness of the statement data).

In the second section, respondents were given fifty pairs of hypothetical CPA reports. They rated the relative similarity of each pair of reports on a ten-point rating scale.

Libby examined the data by means of three approaches. These were the construction of models of the CPAs' and CBLOs' perceptions of the messages intended by the reports, the identification of perceptual dimensions, and the analysis of individual differences in perceptions within each group of subjects. Libby applied the INDSCAL method of multidimensional scaling to analyze the data.

Major Findings and Conclusions

Libby reported findings and conclusions about (1) the extent to which CPAs' and CBLOs' perceptions of the reliability of financial statements were similar and (2) the extent to which CPAs and CBLOs perceived differences in reliability among financial statements accompanied by different types of CPA reports. First, Libby found no large differences between CPAs' and CBLOs' perceptions of reliability. As a result, he concluded that fears of miscommunication of CPAs' intended messages by audit reports may not have been justified, at least insofar as more sophisticated users are concerned. Second, Libby found that both CPAs and CBLOs perceived differences in reliability among financial statements accompanied by categories of reports. He found that respondents attributed greater reliability to financial statements as the categories of the reports accompanying them progressed from disclaimer reports to qualified audit reports to unqualified audit reports.

Major Findings Related to the Present Research

Libby's research was similar to the present study because he compared the extent to which CPAs and CBLOs had similar perceptions of the reliability of financial statements. Also, like the present study, he examined whether CPAs and CBLOs perceived different assurances about the reliability of financial statements accompanied by different types of reports. Like the present study, Libby's research used more than one meaning of reliability. These were reliability of financial statement data, reliability of auditor's judgement, and reliability of financial statement data for decisions.

Libby found that, given CPA reports on both unaudited and audited financial statements, CPAs and CBLOs shared similar views about the reliability of the statements. When applied to the present study, these results suggest that CPAs' perceptions of the reliability of financial statements may be similar to those of CBLOs when the statements are accompanied (1) by no CPA report, (2) by the CPA's compilation report, (3) by the CPA's review report, and (4) by the CPA's audit report.

Libby also found that CPAs and CBLOs perceived different assurances about the reliability of financial statements under the conditions of CPA association with unaudited financial statements and the CPA's audit. When applied to the present research, these results suggest that CPAs and CBLOs may perceive differences in reliability (1) between compiled and audited financial statements and (2) between reviewed and audited financial statements.

## Reckers and Pany

### Description of the Study

Reckers and Pany investigated whether different forms of CPA association with quarterly financial information affects users' perceptions of the reliability of the information.[7] In addressing this question, the researchers examined financial analysts' perceptions of the reliability of quarterly financial information disclosed under different forms of CPA association.

The researchers mailed questionnaires to randomly selected Chartered Financial Analysts (CFAs) located throughout the United States. Questionnaires were returned by sixty-one CFAs (31% response rate).

The questionnaires depicted three conditions of CPA association with quarterly financial information: no CPA association, a quarterly limited review, and a quarterly audit. Following each condition, the questionnaire contained an eleven-point rating scale on which respondents rated their degree of confidence that the quarterly information was free from accounting errors. Reckers and Pany analyzed the data by using descriptive parametric statistics.

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[7] Philip M. J. Reckers and Kurt J. Pany, "Quarterly Statement Reliability and Auditor Association," Journal of Accountancy, October 1979, pp. 97-100.

Major Findings and Conclusions

Reckers and Pany found that CFA respondents attributed greater reliability to the financial information as the degree of CPA association progressed from no CPA association to quarterly limited reviews to quarterly audits. However, the researchers found only a small difference between quarterly limited reviews and quarterly audits with respect to the CFAs' perceptions of reliability. As a result, they concluded that the CFA respondents might have attributed unwarranted reliability to the quarterly limited reviews.

Major Findings Related to the Present Research

Like the present research, Reckers and Pany investigated whether users perceive differences in the reliability of financial information under different conditions of CPA association with the information. The results indicated that financial analysts (1) perceived differences in reliability between no CPA association with quarterly financial information and quarterly limited reviews, (2) perceived differences in reliability between no CPA association with quarterly financial information and quarterly audits, and (3) perceived less clearly differences in reliability between quarterly limited reviews and quarterly audits. When applied to the present research, these results suggest that users may (1) perceive differences in the reliability of financial statements with no CPA association and financial statements reviewed by a CPA, (2) perceive differences in the reliability of financial statements with no CPA association and financial statements audited by a CPA, and (3) perceive less clearly differences in the reliability between reviewed and audited financial statements.

## Summary of Findings and Limitations

This section first summarizes the findings of the previous research and then describes the limitations of these studies.

### Findings

Previous research has contributed empirical information which can be helpful in answering the following general research questions:

1. Do CPAs and users share similar perceptions about the reliability of financial statements under the conditions of no CPA association with the statements and CPA association?

2. Do CPAs and users perceive differences in the reliability of financial statements under the conditions of no CPA association with the statements and CPA association?

Two studies (Bainbridge, Libby) addressed the first general research question. Given CPA association with audited financial statements, both researchers found that CPAs and CBLOs shared similar views about the reliability of the statements. However, given CPA association with unaudited financial statements, the researchers reported different results. Bainbridge found that CPAs and CBLOs did not share similar views about the reliability of unaudited statements while Libby reported that CPAs and CBLOs did share similar views about the reliability of the statements.

With respect to the second general research question, the studies provided two kinds of results. First, five studies (Guy et al. Winters, Fiebelkorn, Bainbridge, Libby) indicated that CPAs and users perceived differences in the reliability of financial statements with no CPA association, CPA association with unaudited financial statements, and audited financial statements. According to these studies, CPAs and users attributed increasing reliability to financial statements as the degree of CPA association progressed from no CPA association with financial statements to CPA association with unaudited financial statements to CPA association with audited financial statements. Second, two studies (Pany, Reckers and Pany) indicated that financial analysts perceived no differences in the reliability of financial information under the conditions of limited review and audit.

## Limitations

Limitations of the previous studies relate to (1) the types of CPA association with financial statements, (2) the meaning of "reliability," and (3) the generalizability of their results. Table 2-1 summarizes the limitations of the previous research.

One limitation, as shown in the first column of Table 2-1, is that none of the researchers examined compilations and reviews as types of CPA association with financial statements. Instead, these researchers considered: no CPA association with financial statements (Fiebelkorn, Bainbridge, Pany, and Reckers and Pany); CPA association with unaudited financial statements, reported by an opinion disclaimer (Guy et al., Winters, Fiebelkorn, Bainbridge, Libby); CPA association with unaudited financial statements, reported by a limited review (Pany, Reckers and Pany); CPA association with audited financial statements, reported by an opinion disclaimer (Libby); CPA association with audited financial statements, reported by a qualified opinion (Guy et al., Libby); and CPA association with audited financial statements, reported by an unqualified opinion (Guy et al., Fiebelkorn, Bainbridge, Pany, Libby, Reckers and Pany).

TABLE 2-1

LIMITATIONS OF THE PREVIOUS RESEARCH

| Previous Research | Were compilations and reviews, as defined by SSARS #1, used? | Was reliability, as defined by the present research, used? | Were users or CPAs randomly sampled? | Were users or CPAs selected from different bank or firm sizes? | Were inferential statistics applied to the data? |
|---|---|---|---|---|---|
| Guy et al. | No | No | ...[1] | Yes | No |
| Winters | No | No | Yes | Yes | No |
| Fiebelkorn | No | No | Yes | No | Yes |
| Bainbridge | No | No | Yes | Yes | Yes |
| Pany | No | No | No | No | Yes |
| Libby | No | No | No | No | Yes |
| Reckers and Pany | No | No | Yes | Yes | No |

[1]Guy et al. surveyed all Texas members of Robert Morris Associates.

Another limitation, indicated in the second column of Table 2-1, is that the researchers did not explain clearly the meaning of "reliability" in their questionnaires. These researchers suggested the concept of reliability through different expressions. These were: "rely," "reliance," "reliable," or "reliability" (Guy et al., Winters, Fiebelkorn, Bainbridge, Libby); "not false or misleading," and "in conformity with generally accepted accounting principles" (Winters); and "free from accounting errors" (Pany, Reckers and Pany). Questionnaire respondents could have misinterpreted these meanings of reliability. For example, respondents could have interpreted "reliance on financial statements" as a perception of the reliability of financial statements or as a measure of their actual reliance on the statements for decision making. Respondents could have interpreted "accounting errors" as unintentional bookkeeping mistakes or as intentional distortions.

A final limitation which is summarized in the last three columns of Table 2-1 concerns three aspects of the generalizability of results. This limitation was apparent when the researchers either (1) did not obtain representative perceptions of CPAs and users or (2) did not apply inferential statistics to the data. In two studies (Pany, Libby), the researchers selected subjects nonrandomly. Also, in three studies (Fiebelkorn, Pany, Libby), the researchers either selected CPAs from large firms only, or selected CBLOs or financial analysts from large banks only. Finally, in three studies (Guy et al., Winters, Reckers, and Pany), the researchers did not apply inferential statistics to the data. Therefore, their results could not be generalized to larger populations.

## Improvements Made by the Present Research

The present research contributes empirical information about the general research questions stated in the preceding section by improving upon the limitations of previous research. These limitations relate to (1) the types of CPA association with financial statements, (2) the meaning of "reliability," and (3) the generalizability of results.

The present research first improves upon the previous research by referring to compilation and review reports instead of opinion disclaimer reports. For nonpublic businesses, compilation and review reports replaced opinion disclaimer reports on unaudited financial statements. Thus, the present study refers to four conditions: no CPA association with financial statements; CPA association with compiled financial statements, accompanied by a compilation report; CPA association with reviewed financial statements, accompanied by a review report; and CPA association with audited financial statements, accompanied by an unqualified audit report.

Next, the present study improves upon prior research by specifying the definition of "reliability." An aggregate meaning of reliability designed to be understandable to both CPAs and users is used. The definition of reliability used in the present study is the extent to which financial statements are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of an existing material unintentional error, (4) free from the effects of an existing material management fraud, (5) free from the effects of an existing material employee fraud, and (6) evaluated by a CPA who is independent of management.

Finally, the present research improves upon the limitation concerning generalizability of results. In this study, CPAs were randomly selected from firms of different sizes and bankers were randomly selected from banks of different sizes in order to obtain representative views of CPAs and bankers. Further, inferential statistics were applied to the data to permit generalizations about the perceptions of CPAs and bankers.

## Summary

This chapter reviewed seven studies which were similar in scope to the present research. Following this review, the chapter summarized both the findings and limitations of these previous studies. A final section of the chapter described how the present research improves upon the limitations of these studies.

The next chapter reviews legal cases in which CPAs and users did not share similar perceptions about either (1) the substance of the CPA's engagement, or (2) the CPA's assurances accompanying unaudited financial statements. The chapter describes how the courts' decisions in these cases exposed problems in the CPA-user communication process regarding unaudited financial statements.

# CHAPTER III

## REVIEW OF LEGAL CASES

This chapter reviews legal cases which uncovered problems in the CPA-user communication process with respect to unaudited financial statements. As described in Chapter I, AICPA auditing standards before 1979 did not require the CPA to perform auditing procedures on the unaudited financial statements of nonpublic businesses. The CPA reported on these statements by issuing an opinion disclaimer, in which the CPA did not express any assurances about the reliability of the statements. Problems related to the auditing procedures CPAs performed on unaudited financial statements and user's perceptions of assurances about these statements resulted from these standards.

The purpose of reviewing the legal cases is to describe actual situations in which CPAs and users did not share similar perceptions about either (1) the substance of the CPA's engagement, or (2) supposed CPA assurances accompanying unaudited financial statements. The term, "the substance of the CPA's engagement" refers to the type of CPA engagement performed: either an unaudited financial statement engagement or an audit engagement. In some of the legal cases, users understood that the statements were audited, whereas CPAs denied that the engagements involved audit-type responsibilities. The term "CPA assurances accompanying unaudited financial statements" refers to the assurances supposedly implied by an unaudited financial statement opinion disclaimer. In some cases, users perceived audit-type assurances about the financial statements, whereas CPAs believed that the disclaimer provided no assurances whatsoever about the statements. The courts resolved these disputes by interpreting AICPA standards to determine either the substance of the CPA's engagement or the CPA's responsibilities with respect to unaudited financial statements. In addition, the courts applied a number of legal criteria to the cases.

Limitations of reviewing legal cases involve (1) the meaning of "reliability," (2) the selection of cases, and (3) the generalizability of court decisions. The first limitation is that the court decisions often refer to users' "reliance on financial statements," and do not refer to users' perceptions of the "reliability of financial statements." (See definitions of these terms in Chapter I.) The present study emphasizes CPAs' and users' perceptions of the reliability of financial statements. Another limitation of reviewing legal cases is the case selection. This review covers only selected common law cases dealing with users' reliance on unaudited financial statements, but there may be others. A final limitation is the degree to which the courts' decisions can be generalized to other cases. The ruling in each case is based on the facts and circumstances of that particular case. Because each case is, to some extent, unique, a ruling in one case may not apply to other cases.

The chapter first reviews the legal cases. Each case is reviewed in terms of: the arguments to support the user's position; the arguments to support the CPA's position; the decision of the court; and the relationship of the court's decision to the present research. A concluding section summarizes the legal cases and relates the decisions of these courts to the present research.

## Stanley L. Bloch, Inc. v. Klein

### Description of the Case

In Bloch v. Klein,[1] a business owner attributed audit-type assurances to financial statements prepared by Klein, a CPA. In particular, Bloch, the business owner, alleged that Klein negligently misrepresented an April 30, 1957, balance sheet, which overstated inventory by $37,000. The basis of Bloch's claim was that the balance sheet was issued on the CPA's stationery without an opinion disclaimer. Since an AICPA auditing standard required Klein to disclaim audit responsibility on each page of the statements, the absence of the disclaimer implied that he was responsible for auditing the statements. Furthermore, Klein knew of facts which indicated that the balance sheet was erroneous. Klein argued that the oral retainer indicated an unaudited financial statement engagement and consequently, no responsibility existed to detect the inventory error.

The New York County Supreme Court agreed with Bloch that the absence of the opinion disclaimer on each page of the financial statements implied Klein's audit responsibility for the statements. Further, the court determined that Klein should have exercised the care and competence reasonably expected of CPAs to ascertain the facts on which the report was based. Klein's failure to notify Bloch about the erroneous balance sheet constituted actionable negligence.

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[1] Stanley L. Bloch, Inc. v. Klein, 258 N.Y.S. 2d 501, 1965.

Court Decision Related to the Present Research

The decision in Bloch v. Klein was one of the first examples of a court's distinguishing between unaudited financial statement engagements and audit engagements. The court determined that, in accordance with AICPA auditing standards, the substance of the CPA's engagement was an audit. Therefore, the CPA was responsible to third parties for audit-type assurances accompanying the financial statements. By distinguishing unaudited financial statement engagements from audits, the court recognized that CPA assurances accompanying unaudited financial statements were different from assurances accompanying audited financial statements. The present research examines whether CPAs and users have similar perceptions of the reliability of financial statements for compilation, review, and audit engagements.

## 1136 Tenants' Corporation v. Max Rothenberg and Co.

Description of the Case

1136 Tenants' Corporation v. Max Rothenberg and Co.[2] was another example of a case in which a CPA and user did not share similar perceptions about the substance of the CPA's engagement. 1136 Tenants' Corporation, an apartment owner group, relied on financial statements prepared by Max Rothenberg and Company, a CPA firm. After discovering that Riker, the apartment manager, perpetrated accounts payable defalcations, the corporation charged that the CPA firm negligently

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[2]1136 Tenants' Corporation v. Max Rothenberg and Company, 277 N.Y.S. 2d 996, 1967; 319 N.Y.S. 2d 1007, 1971; 281 N.E. 2d 846, 1972; Emanuel Saxe, "Unaudited Financial Statements: Rules, Risks and Recommendations," CPA Journal, June 1972, pp. 457-464+ (hereafter cited as Saxe, "Unaudited Financial Statements").

misrepresented the financial statements. Furthermore, the corporation contended that they hired the CPA firm as auditors, not as bookkeepers. Consequently, 1136 Tenants' Corporation argued that the CPAs failed to perform expected auditing procedures and that they did not exercise due care when they failed to inform the corporation about the suspicious accounts payable. Max Rothenberg and Company countered that the oral retainer provided that the CPA firm should prepare tax returns, perform bookkeeping services or write-up work, and prepare financial statements without verification. The CPA firm went on to argue that past letters accompanying the financial statements asserted that the statements were prepared from the books of the corporation without independent verification. Because they were associated with unaudited financial statements, Max Rothenberg and Company claimed that professional standards did not require them to detect defalcations in the statements.

The New York County Supreme Court ruled on four issues in this case. First, the court determined that Max Rothenberg and Company was engaged to audit and not merely to write up the corporation's books and records. The court relied on evidence that some auditing procedures were performed which would not normally have been done in write-up work. Second, the court challenged an AICPA auditing standard which stated that CPAs were not responsible to perform any auditing procedures in the preparation of unaudited financial statements. In this case, the court ruled that certain auditing procedures were necessitated and mandated under the oral retainer. Third, the court judged that the CPA firm was responsible for detecting the defalcations. Regardless of whether the CPAs received the accounts payable invoices for purposes of audit or otherwise, a duty existed to detect the defalcations based on the evidence in the case. Finally, the court recognized the CPA's duty to inform the corporation of known suspicious circumstances. Max Rothenberg and Company had a duty to inform the corporation when they became aware that material invoices purportedly paid by Riker were missing.

Court Decision Related to the Present Research

The court in the 1136 Tenants' Corporation case determined that the substance of the CPA firm's engagement was an audit. By challenging AICPA auditing standards, which did not require the CPA to perform auditing procedures on unaudited financial statements, this decision helped to expose three problems in the CPA-user communication process with respect to unaudited financial statements. First, the decision contributed to uncertainties among CPAs as to what auditing procedures they should perform on unaudited statements. Some CPAs performed limited auditing procedures on unaudited financial statements in order to provide clients with a satisfactory level of service and to preclude the CPA's association with substandard statements.[3] Other CPAs performed no auditing procedures on unaudited financial statements in order to avoid users' perceptions of audit-type assurances about the statements.[4] A second problem was that if a CPA performed limited auditing procedures on unaudited financial statements, then the CPA might have achieved some assurances about the statements, despite a denial of assurances contained in the opinion disclaimer. A final

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[3] Terrell, "Minimum Standards," p. 58.

[4] Saunders, "Procedures In Minimizing Risk," p. 26.

problem was that users might attribute some assurances to the statements despite the opinion disclaimer.

The present study examines possible communication problems between CPAs and users for different types of CPA engagements. It provides empirical information about CPAs' and users' perceptions of the reliability of compiled, reviewed, and audited financial statements.

## Ryan v. Kanne

### Description of the Case

In Ryan v. Kanne,[5] a user attributed audit-type assurances to part of the financial statements despite the CPA's opinion disclaimer accompanying the unaudited financial statements. Kanne Lumber and Supply, Inc. relied on the balance sheet of Mid-States Enterprises, Inc. to form a corporate charter and to induce investors to buy stock. Although the financial statements contained an opinion disclaimer by Ryan, a CPA, the oral employment contract allegedly contained a representation made by Ryan with respect to accounts payable. Kanne charged that Ryan negligently misrepresented accounts payable and other accounts. Furthermore, it was proved that Ryan knew that Kanne relied on the report and statements when he contemplated the stock purchase. Ryan argued that the opinion disclaimer nullified any CPA responsibilities and that no contract existed between him and Kanne.

The Iowa Supreme Court awarded damages to Kanne, but only to the extent of the loss, due to the erroneous accounts payable. The court reasoned that liability must depend on the CPA's undertaking and not on a denial of assurances contained in the opinion disclaimer.

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[5]Ryan v. Kanne, 170 N.W. 2d 395 Iowa, 1969.

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The court explained:

> He must perform as agreed whether the work is certified or not. This being so, we have here fact questions as to the substance of the agreement between the parties, as to the care exercised in its performance, and as to the representations made, rather than whether the report was certified or uncertified.[6]

In regard to Ryan's claim of no contract, the court determined that CPA liability for negligence was possible in accordance with the principle of foreseeability.

## Court Decision Related to the Present Research

The Ryan v. Kanne ruling was one of the first court decisions to establish CPA responsibilities for unaudited financial statements. The court challenged AICPA auditing standards, which stated that the CPA's opinion disclaimer on unaudited financial statements contained no assurances about the statements. The court determined that the CPA was responsible for part of the financial statements based on the care exercised by the CPA, the representations made by the CPA, and the principle of foreseeability. The Ryan v. Kanne case further exposed the communication problems between CPAs and users regarding unaudited financial statements. One problem was that CPAs might have achieved some assurances about a part of the financial statements without expressing such assurances. Another problem was that users might have attributed some assurances to part of the financial statements despite the CPA's denial of assurances. The present research examines the possibility that users may attribute some assurances to the reliability of financial statements accompanied by either compilation or review

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[6] Ibid., 170 N.W. 2d 404 Iowa, 1969.

reports.

MacNerland v. Barnes

Description of the Case

Like Ryan v. Kanne, MacNerland v. Barnes[7] was a case in which a user attributed audit-type assurances to part of the unaudited financial statements. MacNerland relied on financial statements to purchase 45,090 stock shares of Continental Rent-A-Car of Georgia, Inc. After discovering erroneous "Automobiles" and "Accounts Payable" accounts, MacNerland contended that Barnes, a CPA, negligently misrepresented the accounts. Barnes countered that the financial statements contained an opinion disclaimer, and that no contract existed between him and MacNerland.

Judge Quillian of the Georgia Court of Appeals cited AICPA auditing standards and a previous case, Ultramares,[8] to reject CPA liability for negligence when there was an opinion disclaimer and no contract. Quillian emphasized the nature of the CPA's opinion disclaimer on unaudited financial statements:

> The statement is designed as a red flag that the accountant in question was not independent with respect to the company on which the financial report was prepared and the statements given were not audited by the accountant. As set forth in No. 38 of the Statement on Auditing Procedures "although the certified public accountant may have prepared, or assisted in preparing, unaudited financial statements, the statements are representations of management, and the fairness of their representation is management's responsibility." In the situation in which we are considering the accounting firm acts as a mere conduit through which the information passes and does

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[7] MacNerland v. Barnes, 129 Ga. App. 367; 199 S.E. 564, 1973.

[8] Ultramares Corporation v. Touche, 255 N.Y. 170; 174 N.E. 441, 1931.

> not assume any responsibility for the correctness of the statements which are management's responsibility.[9]

Despite this decision, however, the court ruled that CPAs could be liable to third parties if the CPA agreed to verify certain accounts contained in the financial statements and neglected to do so.

### Court Decision Related to the Present Research

Unlike the court which decided the Ryan v. Kanne case, the MacNerland v. Barnes court associated the CPA's responsibilities for unaudited financial statements with the CPA's opinion disclaimer report. The court accepted AICPA auditing standards which stated that the CPA's opinion disclaimer on unaudited financial statements contained no assurances about the statements. The compilation report, one of the two reports which replaced the opinion disclaimer, also contains no assurances about the financial statements. A possibility remains that users may perceive some assurances about compiled financial statements in spite of the CPA's denial of assurances. The present research examines to what extent CPAs and users perceive assurances about financial statements which are accompanied by the CPA's compilation report.

## Bonhiver v. Graff

In Bonhiver v. Graff,[10] a user attributed audit-type assurances to financial information contained in the CPA's working papers. Graff, a CPA, was engaged to prepare working papers and adjusting entries for American Allied, an insurance company. During his engagement, state

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[9] MacNerland v. Barnes, 199 S.E. 566, 1973.

[10] Bonhiver v. Graff, 248 N.W. 2d 291, 1976.

insurance examiners inspected American Allied's financial statements. Bonhiver, the receiver of American Allied, argued that Graff allowed the examiners access to the working papers. As a result, it was alleged that the insurance commissioner relied on Graff's representations in the working papers to indicate that American Allied was solvent. After discovering that American Allied was insolvent and that the company's officers misappropriated over $2 million, Bonhiver contended that Graff negligently misrepresented the company's financial situation. Graff disputed the liability because he did not produce audited financial statements, but rather a set of incomplete and unaudited working papers.

Judge Sheran of the Minnesota Supreme Court issued three rulings in this case. He first ruled that Graff made negligent representations to known and reliant third parties. Next, he determined that the CPA should have known about or at least suspected the misrepresented accounts. Finally, the court ruled that Graff's working papers and representations breached the ordinary standard of care.

## Court Decision Related to the Present Research

The Bonhiver v. Graff decision was similar to the Ryan v. Kanne ruling in that both courts established CPA responsibilities for unaudited financial statements. The court ignored AICPA auditing standards, which protected the confidentiality of the CPA's working papers, and determined that the CPA was responsible for the financial information based on other criteria. These criteria were: the representations made by the CPA to known third parties, the care exercised by the CPA, and the CPA's knowledge of suspicious circumstances. This case is another in which a CPA and user did not share similar perceptions of assurances accompanying unaudited financial statements. The present research examines whether CPAs and users share similar perceptions of the reliability of financial statements which are accompanied by compilation and review reports.

## Coleco Industries, Inc. v. Berman v. Zelnick, Sobelman and Company

### Description of the Case

In the Coleco case,[11] a user attributed audit-type assurances to quarterly financial statements despite the CPA firm's opinion disclaimer on the statements. Coleco Industries acquired the Royal All-Aluminum Swimming Pool Corporation by a 100% stock purchase. Coleco relied on Royal's April 30, 1973, unaudited financial statements to consummate the acquisition. The CPA firm of Zelnick, Sobelman and Company was engaged by Royal to prepare the quarterly statements. Coleco and Royal sued the CPA firm for negligently overstating inventory by nearly $50,000. A relevant fact in the case was that the CPA firm admitted that they failed to mechanically calculate inventory correctly and failed to deduct overhead from inventory. Zelnick, Sobelman and Company argued that lack of a contract and association with unaudited financial statements nullified the liability.

The United States Pennsylvania District Court applied the foreseeability principle to establish CPA liability, despite the CPA's association with unaudited financial statements and the lack of a contract. The court determined that Zelnick, Sobelman and Company knew that Royal

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[11] Coleco Industries, Inc. v. Berman v. Zelnick, Sobelman and Company, 423 F. Supp. 275, 1976; 567 F. 2d 569, 1977.

relied on the statements in order to warrant the financial condition of the company to Coleco. The CPAs were held legally responsible to known third parties who reasonably relied on financial statements prepared and submitted to them. Further, the court ruled that avoidance of the inventory errors would have required neither a costing check nor a physical inventory. Coleco recovered $350,000 from the CPA firm in an out-of-court settlement.

### Court Decision Related to the Present Research

Like the Ryan v. Kanne court, the Coleco court established CPA responsibilities for unaudited financial statements, despite an opinion disclaimer. The care exercised by CPA firms in handling inventory accounts and the ability to foresee that third parties would use the statements were used as criteria in determining the CPA firm's responsibilities. Like the previous cases, this one exemplified the dissimilar perceptions between CPAs and users of assurances accompanying unaudited financial statements. The present study provides empirical information about this CPA-user communication problem.

## Seedkem, Inc. v. Safranek

### Description of the Case

Seedkem v. Safranek[12] is a final example of a case in which a user attributed audit-type assurances to unaudited financial statements in spite of the CPA's opinion disclaimer on the statements. Seedkem relied on 1975 financial statements prepared by Safranek, a CPA, in order to advance credit of more than $700,000 to Agri-Products, Inc.

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[12] Seedkem, Inc. v. Safranek, 466 F. Supp. 340, 1979.

After suffering loan defaults from Agri-Products, Seedkem charged that Safranek recklessly and wantonly prepared the statements and knew that the statements did not conform to generally accepted accounting principles. Safranek contended that the unaudited financial statements contained an express disclaimer of opinion and that no other representations on the statements were made.

Judge Denney of the United States Nebraska District Court remanded the case to ascertain whether any express representations or understandings existed between the parties. In his opinion, Denney cautioned that Safranek could be liable for negligence despite an opinion disclaimer on unaudited financial statements:

> Despite the fact that financial statements were expressly marked "unaudited" and the fact that they contained an express disclaimer of opinion would not necessarily mean that the accountant charged with negligence in preparing the statements and with recklessly and wantonly allowing his name to be attached to the statements would not be liable to a third party who advances credit in reliance on the statements.[13]

Applying the foreseeability principle, Denney noted that CPAs could be liable to those who, although not individually foreseen, were members of a limited class whose reliance on the representation was specifically foreseen.

## Court Decision Related to the Present Research

The Seedkem v. Safranek case was another in which a court ruled the CPAs were not relieved of responsibilities for unaudited financial statements. The court suggested that, despite an opinion disclaimer, CPAs were responsible for negligent misrepresentations made to known

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[13] Ibid., 466 F. Supp. 340, 1979.

and reliant third parties. In this case, a CPA and user did not share similar perceptions of assurances accompanying unaudited financial statements. Given the replacement of unaudited financial statements by compiled and reviewed statements, CPAs and users may not share similar perceptions of assurances contained in compilation or review reports. The present research examines this possibility.

## Summary of Court Decisions and Their Relationship to the Present Research

This section summarizes the court decisions, and the next section relates the court findings to the present research.

### Summary of the Court Decisions

The legal cases cited are examples of cases in which CPAs and users did not share similar perceptions about either (1) the substance of the CPA's engagement, or (2) supposed CPA assurances accompanying unaudited financial statements. In two cases (Bloch, 1136 Tenants'), users believed that the CPAs audited the financial statements while the CPAs contended that they were merely associated with unaudited statements. In five other cases (Ryan, MacNerland, Bonhiver, Coleco, Seedkem), users attributed audit-type assurances to unaudited financial statements, despite the CPA's denial of assurances.

The courts in these cases interpreted AICPA auditing standards to determine either the substance of the CPA's engagement or the CPA's responsibilities for unaudited financial statements. In addition, the courts applied a number of legal criteria to resolve these disputes. In both the Bloch and 1136 Tenants' cases, the courts ruled that the substance of the CPA's engagement was an audit. In the Bloch case, the court used AICPA auditing standards to determine whether the CPA was associated with unaudited or audited financial statements. Because the CPA violated these standards with respect to disclaiming responsibility for unaudited financial statements, the court found that the CPA was responsible for audited statements. The court in the 1136 Tenants' case, however, reached its decision by challenging the AICPA auditing standard which specified that CPAs need not perform auditing procedures on unaudited financial statements. The courts in five other cases (Ryan, MacNerland, Bonhiver, Coleco, Seedkem) determined the CPA's responsibilities for unaudited financial statements. The MacNerland court accepted AICPA auditing standards which state that the CPA's opinion disclaimer contains no assurances about the financial statements. This court determined that the CPA's opinion disclaimer relieved the CPA of responsibilities for the correctness of the statements. However, in four cases (Ryan, Bonhiver, Coleco, Seedkem), the courts challenged these AICPA auditing standards. In three of these cases (Ryan, Coleco, Seedkem), the courts decided that the CPA's opinion disclaimer does not necessarily relieve the CPA of all responsibilities pertaining to unaudited financial statements. In the Bonhiver case, the court ruled that the CPA's association with unaudited working papers did not relieve the CPA of all responsibilities for the financial information contained in the working papers.

The courts also determined that CPAs were responsible for parts of the financial statements based on other criteria. These were: (1) duty of care and competence (Bloch, Ryan, Bonhiver, Coleco); (2) representations made about the accounts (Ryan, MacNerland, Bonhiver, Seedkem); (3) knowledge of suspicious circumstances (Bloch, 1136

Tenants', Bonhiver); and (4) foreseeability of users (Ryan, Bonhiver, Coleco, Seedkem).

### Relationship to the Present Research

These legal cases helped to expose the problems previously referred to in this chapter concerning the CPA's association with unaudited financial statements. The AICPA responded to these problems by issuing a compilation and review standard. Applying to nonpublic businesses only, the standard replaced unaudited financial statement engagements and the accompanying opinion disclaimer reports with two types of engagements and reports--compilation and review. But the possibility still remains that CPAs and users may not share similar perceptions about the assurances contained in compilation and review reports. Like the users described in the legal cases, users may attribute audit-type assurances to compilation and review reports.

A primary objective of the present research is to provide empirical information about the similarities with which CPAs and users perceive assurances about the reliability of financial statements accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. If the results of the study indicate that users perceive audit-type assurances for compilation or review reports, then fears of legal risks for CPAs in compilation or review engagements may be well-founded.

## Summary

This chapter reviewed seven legal cases in which CPAs and users did not share similar perceptions about either (1) the substance of the CPA's engagement, or (2) supposed CPA assurances accompanying unaudited financial statements. In both types of cases, users attributed audit-type assurances to the financial statements, whereas CPAs denied audit-type responsibilities for the statements. Most of the courts in these cases interpreted AICPA auditing standards to determine either the substance of the CPA's engagement or the CPA's responsibilities for unaudited financial statements.

The next chapter chronologically reviews significant events in the AICPA's development of a compilation and review standard intended to overcome problems associated with unaudited financial statements and limited procedure engagements.

# CHAPTER IV

## DEVELOPMENT OF COMPILATIONS AND REVIEWS

This chapter chronologically reviews significant events in the development of AICPA standards which led to the establishment of compilations and reviews. Formerly, there were two types of CPA engagements on the financial statements of nonpublic businesses: unaudited financial statement engagements and certain limited procedure engagements. The chapter describes various communication problems between CPAs and users which resulted from these types of engagements. The chapter then describes how the AICPA responded to these problems with the issuance of auditing standards and a separate compilation and review standard.

The chapter is comprised of four sections. The first section describes the significant events in the development of AICPA standards pertaining to unaudited financial statements for the time period, 1896-1946. During this period, CPAs were associated with unaudited financial statements, but the accounting profession emphasized procedural and reporting guidance for audit engagements. The next section describes the events and standards associated with unaudited financial statements and limited procedure engagements for the time period, 1947-1961. During this period, the accounting profession first officially recognized unaudited financial statement engagements. Also, CPAs began to practice certain types of limited procedure engagements during this time. The third section describes the events and standards related to unaudited financial statements and limited procedure engagements for the time period, 1962-1976. These events and standards immediately preceded the development of compilations and reviews. Finally, the last section describes how the accounting profession responded to the problems associated with unaudited financial statements and limited procedure engagements by issuing a separate compilation and review standard for nonpublic businesses.

## Developing Auditing Standards: 1896-1946

During this period, the accounting profession recognized the need on the part of third parties for CPA association with financial statements, and the American Institute of Accountants (AIA)[1] developed and issued auditing standards to guide such an association. For example, bankers wanted CPA association with a loan customer's audited financial statements, because they relied on the CPA's assurances to provide input for the loan decision.[2] Before these standards were developed, third parties received a variety of CPA reports as a result of different types of CPA engagements. In addition, the absence of professional guidelines for these engagements and the corresponding reports contributed to this variety.[3] In 1939, the AIA issued Statement on Auditing Procedure Number 1: Extensions of Auditing

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[1]The name of the American Institute of Accountants (AIA) was changed in 1957 to the American Institute of Certified Public Accountants (AICPA) .

[2]Charles C. Kimball, "Accountant's Reports from a Banker's Viewpoint," Journal of Accountancy, April 1937, pp. 268-269.

[3]Ibid.; William H. Bell, "Staff Preparation and Editing of Reports," Journal of Accountancy, February 1925, pp. 116-117.

Procedures (SAP #1) in response to this problem. This standard required the CPA to issue either an audit opinion on the fairness of the financial statements, taken as a whole, or to report on the findings of the engagement without expressing an opinion.[4] With the publication of SAP #1 and other auditing standards, the AIA emphasized the CPA's association with audited financial statements and related audit reports.

The AIA did not recognize the CPA's association with unaudited financial statements during this period. However, Robert H. Montgomery's auditing book reported that the preparation of a balance sheet from the unaudited books of a client was within the scope of a CPA's services. Montgomery further acknowledged that CPAs reported on unaudited financial statements by (1) issuing the statements on plain paper without CPA comments, (2) issuing the statements on the CPA's letterhead without CPA comments, or (3) issuing the statements on the CPA's letterhead with CPA comments. Comments were either a report of findings or a disclaimer, such as "Without Audit," "Tentative," or "Pro Forma."[5] Table 4-1 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which were in effect for unaudited financial statements in 1946 at the end of the first time period under consideration.

Misunderstandings between CPAs and users resulted from the CPA's association with unaudited financial statements. For example, Montgomery

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[4]American Institute of Accountants, Committee on Auditing Procedure, reprinted in Journal of Accountancy, December 1939, p. 380.

[5]Robert H. Montgomery, Auditing Theory and Practice, 5th ed. (New York: The Ronald Press Company, 1934), pp. 694-695.

TABLE 4-1

UNAUDITED FINANCIAL STATEMENTS: 1946

| | Unaudited Financial Statements |
|---|---|
| Authoritative Body | None |
| AICPA Standards | None |
| Engagement Tasks | Prepare financial statements |
| Report Forms | Financial statements on plain paper without CPA comments, or<br>Financial statements on CPA's letterhead without CPA comments, or<br>Financial statements on CPA's letterhead with marking i.e. "Tentative," "Without Audit," "Pro Forma," or<br>Financial statements on CPA's letterhead with report of findings |

explained that CPAs did not intend to give assurances to third parties about unaudited financial statements: "The representation by a client that a statement obtained in this manner has behind it the auditor's assurances of its correctness is pure fraud on the part of the client."[6] Nevertheless, when the financial statements appeared on the CPA's letterhead, it was feared that users attributed audit-type assurances to the statements merely because a CPA was associated with the statements.[7] Also, there was uncertainty about how third parties perceived the association of CPAs with financial statements which appeared on the CPA's

[6]Ibid.

[7]Ibid., p. 695; John L. Carey, "Editorial," Journal of Accountancy, September 1941, p. 195.

letterhead without comments. Bankers could, for example, variously perceive that the CPA typed the statements, prepared the statements without audit, applied limited auditing procedures to the statements, or audited the statements.[8]

## Recognizing Unaudited Financial Statements: 1947-1961

The accounting profession continued to emphasize the CPA's attest function during this period. This function comprised the CPA's association with audited financial statements and the CPA's expression of an opinion on the fairness of the statements taken as a whole. Performance of this function gave credibility to the financial statements and increased users' reliance on the statements. Reporting problems remained, however, when CPAs performed unaudited financial statement engagements and limited procedure engagements. One problem was that users might not have understood the CPA's responsibilities for either unaudited financial statements or limited procedure engagements. A related problem was that users might have attributed audit-type assurances to either unaudited financial statements or limited procedure engagements.

### Unaudited Financial Statements

The AIA first recognized the CPA's association with unaudited financial statements in Statement on Auditing Procedure Number 23: Clarification of the Accountant's Report When Opinion is Omitted (SAP #23). SAP #23 modified SAP #1 by requiring the CPA to issue either an audit opinion or an opinion disclaimer about the fairness of the

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[8]Victor H. Stempf, "Whose Balance Sheet Is It?" New York Certified Public Accountant, May 1941, p. 443.

financial statements.[9] SAP #23 required the CPA to report on unaudited financial statements by (1) issuing the statements on plain paper without CPA comments or (2) issuing the statements on the CPA's letterhead with CPA comments. Comments were specified as either a report of findings, accompanied by an opinion disclaimer, or the disclaimer, "Prepared from the Books Without Audit," appearing prominently on each page of the financial statements.[10] Table 4-2 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which were in effect for unaudited financial statements in 1961 at the end of the time period under consideration.

SAP #23 was intended to reduce misunderstandings between CPAs and users in two ways. First, the standard eliminated the issuance of unaudited financial statements on the CPA's letterhead without comments. Second, the standard required the CPA's disclaimer as a warning to third parties that the statements were not audited. Two problems, however, were not resolved by SAP #23. One problem was that CPAs continued to issue financial statements on plain paper without comments. Users of these statements may have been uncertain about the degree of CPA association with and responsibilities for such statements.[11] The second problem was that users may not have understood the meaning of the CPA's opinion disclaimer. For example, bankers may have attributed to the

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[9] American Institute of Accountants, Committee on Auditing Procedure, reprinted in Journal of Accountancy, June 1949, p. 469.

[10] Ibid.

[11] Richard A. Nest, "Statement No. 38--Unaudited Financial Statements," Journal of Accountancy, February 1968, pp. 63-64; W. H. Turlington, "Letters to the Journal," Journal of Accountancy, November 1965, p. 30.

TABLE 4-2

UNAUDITED FINANCIAL STATEMENTS AND LIMITED PROCEDURE ENGAGEMENTS: 1961

| | Unaudited Financial Statements | Limited Procedure Engagements |
|---|---|---|
| Authoritative Body | Committee on Auditing Procedure | None |
| AICPA Standards | SAP #23 Clarification of Accountant's Report When Opinion is Omitted (Revised 1949) | None |
| Engagement Tasks | Prepare financial statements | Review interim financial statements by applying limited auditing procedures |
| Report Forms | Financial statements on plain paper without CPA comments, or<br>Financial statements on CPA's letterhead with "Prepared from Books Without Audit" marked on each page of statements, or<br>Financial statements on CPA's letterhead with report of findings and opinion disclaimer | Comfort letter |

statements audit-type assurances about the reliability of the financial statements, merely because a CPA was associated with the statements.[12]

Limited Procedure Engagements

During this period, CPAs practiced a limited procedure engagement that was similar to today's review engagement under SSARS #1. The limited procedure engagement was a review of interim financial statements. In carrying out this review engagement, the CPA read minutes of meetings, read the interim financial statements, and performed analytical and inquiry procedures. The CPA reported the results of this review by issuing a "comfort letter," which was addressed to the client but normally used by underwriters. In this letter, the CPA provided limited assurance that nothing came to his attention during the review which would require modification of the unaudited financial statements.[13] Table 4-2 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which were in effect for limited procedure engagements at the end of 1961.

The review of interim financial statements created two problems for CPAs and users. One problem, shown in Table 4-2, was that the accounting profession provided neither procedural nor reporting guidance for CPAs who performed this review. As a result, CPAs were uncertain about what auditing procedures they should perform on these engagements.[14] Another problem was that users might have attributed

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[12] J. S. Seidman, "Letters to the Journal," Journal of Accountancy, March 1966, p. 29.

[13] A. P. L. Prest, "The Limited Review of Unaudited Interim Statements," Journal of Accountancy, October 1957, p. 50.

[14] Ibid., p. 52.

audit-type assurances to the financial statements because CPAs performed certain auditing procedures on the statements.[15]

## Standards for Unaudited Financial Statements: 1962-1976

Despite continued emphasis on the CPA's attest function, in 1962 the accounting profession began to issue reporting standards with respect to CPA association with unaudited financial statements. However, the new standards did not provide procedural or reporting guidance for CPAs who performed limited auditing procedures on unaudited financial statements. This situation contributed to communication problems between CPAs and users concerning the CPA's association with unaudited financial statements and limited procedure engagements.

### Unaudited Financial Statements

The AICPA issued two standards and a guide regarding CPA association with unaudited financial statements. These were: *Statement on Auditing Procedure Number 32: Disclaimers* (*SAP #32*); *Statement on Auditing Procedure Number 38: Unaudited Financial Statements* (*SAP #38*); and *Guide for Engagements of CPAs to Prepare Unaudited Financial Statements* (*Guide*).

*SAP #32* was the first AICPA standard to provide reporting guidance regarding CPA association with unaudited financial statements. Major points of this standard included:

1. Definition of unaudited financial statement engagements as the performance of no auditing procedures or insignificant auditing procedures.

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[15]Ibid.

2. Requirement that the CPA report on unaudited financial statements by marking "Unaudited" on each page of the statements, with or without other CPA comments.

3. Recommendation that the CPA report on unaudited financial statements by issuing an opinion disclaimer when the unaudited statements were not accompanied by other CPA comments.

4. Requirement that the CPA report on unaudited financial statements by issuing an opinion disclaimer when the statements were accompanied by other CPA comments.[16]

SAP #38 was the first AICPA standard to separately consider unaudited financial statements. Major provisions of this standard accomplished the following:

1. Distinguished an accounting service from an audit engagement.

2. Described an unaudited financial statement engagement as an accounting service. An accounting service included assistance in adjusting and closing the general books, and preparation of or assistance in the preparation of financial statements.

3. Described unaudited financial statement engagements as the performance of no auditing procedures, or the performance of insufficient auditing procedures to permit the expression of an audit opinion.

4. Required CPA association with plain paper financial statements.

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[16] American Institute of Certified Public Accountants, Committee on Auditing Procedure, Statement on Auditing Procedure Number 32: Qualifications and Disclaimers. Reprinted in Journal of Accountancy, January 1963, pp. 68-69.

5. Required the CPA to report on unaudited financial statements by issuing an opinion disclaimer and marking "Unaudited" on each page of the statements.

6. Permitted CPA association with general-use and internal-use unaudited financial statements. General-use unaudited statements, which required appropriate disclosures, were distributed to third parties. Internal-use unaudited statements, which did not require appropriate disclosures, were not distributed to third parties. The CPA reported on internal-use statements by adding a disclosure disclaimer to the report.[17] Table 4-3 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which were in effect for these two unaudited financial statement engagements in 1976 at the end of the time period under consideration. Standards for accounting and review services rendered by CPAs on public business financial statements after 1976 are not discussed in the present research.

Because of legal uncertainties pertaining to the CPA's responsibilities for unaudited financial statements, the AICPA appointed a task force in 1972 to offer guidance with respect to unaudited statements. In 1975, the task force issued Guide for Engagements of CPAs to Prepare Unaudited Financial Statements, which improved procedural and reporting guidelines for CPAs who were associated with unaudited financial statements.[18]

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[17]American Institute of Certified Public Accountants, Committee on Auditing Procedure, Statement on Auditing Procedure Number 38: Unaudited Financial Statements. Reprinted in Journal of Accountancy November 1967, pp. 59-60.

[18]American Institute of Certified Public Accountants, Task Force on Unaudited Financial Statements, Guide for Engagements of CPAs to Prepare Unaudited Financial Statements (New York: AICPA, 1975), pp. 1-34.

TABLE 4-3

UNAUDITED FINANCIAL STATEMENTS: 1976

| | Internal-Use Unaudited Financial Statements | General-Use Unaudited Financial Statements |
|---|---|---|
| Authoritative Body | Auditing Standards Executive Committee | Auditing Standards Executive Committee |
| AICPA Standards | SAP #32 Qualifications and Disclaimers (1962)<br>SAP #38 Unaudited Financial Statements (1967)<br>SAS #1 Statements on Auditing Standards (1972) | SAP #32 Qualifications and Disclaimers (1962)<br>SAP #38 Unaudited Financial Statements (1967)<br>SAS #1 Statements on Auditing Standards (1972) |
| Engagement Tasks | Prepare financial statements without applying auditing procedures for internal-use without appropriate disclosures | Prepare financial statements by applying limited auditing procedures for general-use with appropriate disclosures |
| Report Forms | Financial statements on plain paper or CPA's letterhead with "Unaudited"marked on each page of statements, and opinion disclaimer<br>Disclosure disclaimer | Financial statements on plain paper or CPA's letterhead with "Unaudited" marked on each page of statements, and opinion disclaimer |

Although SAP #32, SAP #38, and the Guide explained the CPA's engagement and reporting responsibilities with respect to unaudited financial statements, several problems remained. These included uncertainty among CPAs about the extent of auditing procedures to perform on unaudited financial statements, unauthorized distribution of internal-use financial statements to users, and confusion by users regarding limited scope opinion disclaimers and unaudited financial statement opinion disclaimers.

The first problem of association with unaudited financial statements was that CPAs were uncertain about the extent of auditing procedures to perform on unaudited statements. As described in Chapters I and III, litigation prompted CPAs to perform either limited auditing procedures on unaudited financial statements, or no auditing procedures on the statements. Tables 4-3 and 4-4 summarize these two approaches to CPA engagements with general-use unaudited financial statements.

In addition to litigation, the recommendations of a number of accounting academicians and practitioners contributed to CPA uncertainty about the extent of auditing procedures to perform on unaudited financial statements. Many academicians and practitioners recommended that the accounting profession issue guidelines which would standardize these practices and enable CPAs to express limited assurances about the reliability of the statements. Articles of recommendation came from Chan in 1968, Saxe in 1972, Terrell in 1973, Guy and Mann in 1973, Olson in 1975, and Meddaugh in 1977.[19] The AICPA, however, neither

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[19] Stephen Chan, "A Review of Statement on Auditing Procedure Number 38," New York Certified Public Accountant, March 1968, p. 188 (hereafter cited as Chan, "A Review of Statement Number 38"); Saxe,

recognized nor provided procedural or reporting guidelines for CPAs who performed these limited procedure engagements. They were performed under the guise of unaudited financial statements and reported on by opinion disclaimers and the marking of "Unaudited" on each page of the statements.[20]

Another problem of association with unaudited financial statements was the unauthorized distribution of internal-use unaudited statements to third parties. For example, a survey found that 79% of responding bankers reported at least some use of internal-use unaudited financial statements. This unauthorized distribution indicated that businesses either misunderstood or intentionally disregarded the distribution limitation. In addition, it was possible that users may have attributed unwarranted reliability to these statements, which lacked the appropriate disclosures.[21]

A final problem of association with unaudited financial statements was that third parties might not have understood the differences between a limited scope opinion disclaimer and an unaudited financial statement opinion disclaimer.[22] The former disclaimer referred to a

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"Unaudited Financial Statements," p. 461; Terrell, "Minimum Standards," pp. 54-60; Dan M. Guy and Herschel Mann, "A Practical Guide for Reporting on Limited Examinations of Financial Statements," CPA Journal, July 1973, pp. 557-558; Wallace E. Olson, "A Look at the Responsibility Gap," Journal of Accountancy, January 1975, pp. 56-57; and E. James Meddaugh, "Toward the Limited Review of Unaudited Statements," Journal of Accountancy, June 1977, p. 78.

[20]AICPA, Codification of Statements on Auditing Standards: 1-15, sec. 516.04.

[21]Winters, "Banker Perceptions," p. 30.

[22]D. R. Carmichael, "Accounting and Auditing Problems," Journal of Accountancy, January 1971, pp. 74-75.

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CPA's audit engagement in which restrictions on auditing procedures precluded an audit opinion. The latter disclaimer referred to the CPA's association with unaudited financial statements in which no auditing procedures or only limited auditing procedures were performed by the CPA.

## Limited Procedure Engagements

CPAs during this period performed two types of limited procedure engagements which were similar to review engagements under *SSARS #1*. These were applying limited auditing procedures to unaudited financial statements and reviewing interim financial statements. Table 4-4 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which were in effect for these limited procedure engagements at the end of 1976. Engagements in which CPAs performed limited auditing procedures on unaudited statements have already been discussed in the preceding section of this chapter. As for reviews of interim financial statements, the AICPA intended to reduce misunderstandings between CPAs and users by issuing two standards. These were *Statement on Auditing Standards Number 10: Limited Review of Interim Financial Information* (*SAS #10*), and *Statement on Auditing Standards Number 13: Reports on Limited Review of Interim Financial Information* (*SAS #13*). As part of his review of interim financial statements, *SAS #10* required the CPA to read the minutes of meetings, read the interim statements, and perform analytical and inquiry procedures.[23] *SAS #13* required the CPA to report on the results of this review by

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[23]AICPA, *Codification of Statements on Auditing Standards: 1-15*, sec. 720.10.

TABLE 4-4

LIMITED PROCEDURE ENGAGEMENTS: 1976

| | General-Use Unaudited Financial Statements | Interim Financial Statements |
|---|---|---|
| Authoritative Body | Auditing Standards Executive Committee | Auditing Standards Executive Committee |
| AICPA Standards | SAP #32 Qualifications and Disclaimers (1962)<br>SAP #38 Unaudited Financial Statements (1967)<br>SAS #1 Statements on Auditing Standards (1972) | SAS #10 Limited Review of Interim Financial Information (1975)<br>SAS #13 Reports on Limited Review of Interim Financial Information (1976) |
| Engagement Tasks | Review financial statements by applying limited auditing procedures | Review financial statements by applying limited auditing procedures |
| Report Forms | Financial statements on plain paper or CPA's letterhead with "Unaudited" marked on each page of statements, and opinion disclaimer | Review report with "Unaudited" marked on each page of statements, and opinion disclaimer |

stating the objectives of the review, issuing an opinion disclaimer, and marking "Unaudited" on each page of the statements.[24]

The increasing frequency of limited procedure engagements created several problems for CPAs and users. One problem was the difficulty CPAs and users had in understanding differences among unaudited financial statements, limited procedure engagements, and audits. An accounting practitioner noted this problem:

> The auditor might keep in mind that the difference between significantly audited, partially audited, and unaudited has not been sufficiently defined by the Institute's Auditing Procedure Committee and is often dependent upon the type of engagement and intent of the auditor and client.[25]

Another problem was that the CPA reported on these engagements by issuing an opinion disclaimer on the financial statements. As a result, the CPA might have achieved some assurances about the financial statements but expressed no assurances in the report. Also, users might have perceived some assurances about the statements in spite of the CPA's denial of assurances.

## Development of Compilations and Reviews

Users of nonpublic business financial statements and CPAs recognized the problems associated with unaudited financial statements and limited procedure engagements. For example, users were concerned that AICPA auditing standards did not enable CPAs to express limited assurances about the financial statements as a result of limited procedure engagements. Also, CPAs were concerned that these standards did not provide procedural or reporting guidelines for CPAs who

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[24] Ibid., sec. 519.04.

[25] Chan, "A Review of Statement Number 38," p. 188.

performed limited procedure engagements.[26] At the same time, two AICPA spokesmen challenged the CPA's attest function by advocating an assurance level approach. They explained the need for an assurance level appropriate to the CPA's report on a limited procedure engagement:

> What is needed are forms of assurance that are less than that ascribed to an opinion audit but greater than those ascribed to unaudited financial statements.[27]

> ...the realities of the business world and increasing complexity of professional standards have created a need for a new form of assurance that is less than that expressed as a result of an audit made in accordance with generally accepted auditing standards but certainly greater than that included in the present disclaimer on unaudited financial statements.[28]

The AICPA responded to these concerns and other problems associated with unaudited financial statements and limited procedure engagements by developing a standard for compilations and reviews. Significant events in this development are described below.

In 1975, the AICPA established the Accounting and Review Services Committee (ARSC) as a subcommittee of the Auditing Standards Executive Committee (AudSEC).[29] After two years, the ARSC became a senior technical committee with authority to issue standards for accounting and review services rendered by CPAs on nonpublic business

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[26]Kelley, "Compilation and Review, " p. 19.

[27]D. R. Carmichael, "The Assurance Function--Auditing at the Crossroads," Journal of Accountancy, September 1974, p. 69.

[28]William R. Gregory, "Unaudited, But OK?" Journal of Accountancy, February 1978, p. 61 (hereafter cited as Gregory, "Unaudited, But OK").

[29]The Committee on Auditing Procedure (CAP) was reorganized in 1973 and renamed the Auditing Standards Executive Committee (AudSEC). The Auditing Standards Executive Committee (AudSEC) was reorganized in 1978 and renamed the Auditing Standards Board (ASB).

financial statements. At this point, the ARSC issued four statements which provided directions for its work. Gregory cites them this way:

1. Auditing and accounting services are distinguishable, both conceptually and pragmatically.

2. Financial statement users and CPAs should recognize that providing accounting services in connection with unaudited statements is an acceptable and useful service.

3. The complexity of auditing standards creates a need for lower cost alternatives for CPA association with financial statements.

4. The accounting profession needs specific accounting and review guidance, in the form of standards.[30]

Following these statements, the ARSC issued an exposure draft of its first standard, Compilation and Review of Financial Statements. This proposed standard included the following major provisions:

1. Recognition that businesses need accounting services, compilations, and reviews.

2. Definition of compilations and reviews as the two accounting services for unaudited financial statements.

3. Identification of standards and procedures for compilations and reviews.

4. Requirement that the CPA report on a compilation by issuing a compilation report.

5. Requirement that the CPA report on a review by issuing a review report.

6. Requirement that the CPA express limited assurance in the

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[30] Gregory, "Unaudited, But OK?" p. 63.

review report.

7. Permission for third parties to use compiled financial statements which omit substantially all disclosures.[31]

After this exposure draft was reviewed, the ARSC in 1978 issued Statement on Standards for Accounting and Review Services Number 1: Compilation and Review of Financial Statements (SSARS #1). In 1979, the AICPA modified Rule 204 of its Code of Professional Ethics in order to enforce the standards issued by the ARSC. Rule 204, as modified, required CPAs to comply with or justify departures from ARSC standards.[32]

## Compilations

Since its enactment in 1978, SSARS #1 has enabled CPAs to perform two types of compilation engagements on the financial statements of nonpublic businesses. One type is a compilation of financial statements which omits substantially all disclosures. This compilation is similar to the former internal-use unaudited statements, which did not require appropriate disclosures. The other type is a compilation of financial statements which includes substantially all disclosures. This compilation engagement resembles the former general-use unaudited financial statement engagement in which CPAs performed no auditing procedures on the statements. Table 4-5 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which pertain to these two types of compilations.

The objective of both types of CPA compilations is to present management's representations in the form of financial statements

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[31]Kelly, "Compilation and Review," p. 19.

[32]AICPA, Code of Professional Ethics, sec. 204.01, Appendix D.

TABLE 4-5

COMPILATIONS AND REVIEWS

| | Compilations | | Reviews |
|---|---|---|---|
| | Compilations which omit substantially all disclosures | Compilations which include substantially all disclosures | |
| Authoritative Body | Accounting and Review Services Committee | Accounting and Review Services Committee | Accounting and Review Services Committee |
| AICPA Standards | SSARS #1 Compilation and Review of Financial Statements (1978) | SSARS #1 Compilation and Review of Financial Statements (1978) | SSARS #1 Compilation and Review of Financial Statements (1978) |
| Engagement Tasks | Compile financial statements which omit substantially all disclosures | Compile financial statements which include substantially all disclosures | Review financial statements by applying limited auditing procedures |
| Report Forms | Compilation report with "See Accountant's Compilation Report" marked on each page of the financial statements<br>Disclosure disclaimer | Compilation report with "See Accountant's Compilation Report" marked on each page of the financial statements | Review report with "See Accountant's Review Report" marked on each page of the financial statements |

without expressing any assurances about the statements. SSARS #1 requires the CPA to read the financial statements to consider whether the statements appear appropriate in form and free from material errors.[33] The CPA is required to communicate the results of a compilation by issuing a compilation report and marking each page of the financial statements with a reference such as "See Accountant's Compilation Report."[34] An example of a compilation report provided by the ARSC follows:

> The accompanying balance sheet of XYZ Company as of December 31, 19xx, and the related statements of income, owner's capital, and changes in financial position for the year then ended have been compiled by us.
>
> A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.[35]

If the financial statements omit substantially all disclosures, then SSARS #1 requires that the CPA add a third paragraph to the compilation report:

> Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.[36]

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[33]ARSC, Compilation and Review of Financial Statements, par. 13.

[34]Ibid., pars. 4, 14, 16.

[35]Ibid., par. 17.

[36]Ibid., par. 21.

Further, if the CPA is not independent in a compilation engagement, then SSARS #1 requires the CPA to add the following sentence to the compilation report, "We are not independent with respect to XYZ Company."[37]

Reviews

The enactment of SSARS #1 also established the current definition of a review as a limited procedure engagement on the financial statements of nonpublic businesses. A review is similar to a limited procedure engagement dealing with both unaudited and interim financial statements. In both reviews and limited procedure engagements, the CPA is required to read the financial statements and to perform analytical and inquiry procedures.[38] Table 4-5 summarizes the authoritative bodies, AICPA standards, engagement tasks, and report forms which pertain to reviews.

The objective of a review by a CPA is to perform certain auditing procedures which provide the CPA with a reasonable basis for expressing limited assurance that no material modifications should be made to the statements in order for them to be in conformity with generally accepted accounting principles.[39] The CPA is required to communicate the results of a review by issuing a review report and marking each page of the financial statements with a reference such as "See Accountant's Review Report."[40] An example of a review report

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[37] Ibid., par. 22.

[38] Ibid., par. 27.

[39] Ibid., par. 4.

[40] Ibid., pars. 32, 34.

provided by the ARSC follows:

> We have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19xx, and the related statements of income, owner's capital, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management.
>
> A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.
>
> Based on our review, we are not aware of any material modifications that should be made to the accompanying statements in order for them to be in conformity with generally accepted accounting principles.[41]

This review report assumes that the financial statements include appropriate disclosures and that the CPA is independent.

## Summary

This chapter chronologically reviewed significant events in the development of an AICPA standard for compilations and reviews. This standard was developed in response to problems associated with unaudited financial statements and limited procedure engagements.

In spite of the issuance of this new standard, CPAs and users may still misperceive assurances about the financial statements accompanying compilation or review reports. For example, users may misperceive the various levels of assurances provided by compilation reports, review reports, and audit reports. Another possibility is that users may attribute audit-type assurances to financial statements accompanied

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[41] Ibid., par. 35.

by compilation reports or review reports. A primary objective of the present study is to provide empirical information on CPAs' and users' perceptions of the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. If the results of the present study indicate that users do not perceive different assurances among the reports, or that users attribute audit-type assurances to compilation or review reports, then fears of communication problems regarding compilations and reviews may be warranted.

The next chapter explains the methodology used in the present research to provide this empirical information.

# CHAPTER V

# METHODOLOGY

This chapter discusses the methodology used in the present research to empirically test the effectiveness of the communication process between certified public accountants (CPAs) and bankers. Methodological topics are: the research questions and research hypotheses; the questionnaire; questionnaire bias; the sample groups of bankers; the sample group of CPAs; and statistical analyses.

## Research Questions and Research Hypotheses

The present study was undertaken to provide empirical information about six research questions and related research hypotheses. These research questions and hypotheses examined the similarities with which CPAs and bankers perceive assurances about the reliability of financial statements accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. Reliability was defined as the extent to which financial statements are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of an existing material unintentional error, (4) free from the effects of an existing material management fraud, (5) free from the effects of an existing material employee fraud, and (6) evaluated by a CPA who is independent of management. The research questions and corresponding hypotheses follow:

Research Question Number 1: Do CPAs and users share similar views about the reliability of financial statements when there is no CPA association with the statements?

Hypotheses $H_{N1}$-$H_{N5}$: When there is no CPA association with the financial statements, CPAs and bankers share similar views that the statements are:

$H_{N1}$: in conformity with generally accepted accounting principles.

$H_{N2}$: accompanied by all material disclosures.

$H_{N3}$: free from the effects of an existing material unintentional error.

$H_{N4}$: free from the effects of an existing material management fraud.

$H_{N5}$: free from the effects of an existing material employee fraud.

Research Question Number 2: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's compilation report?

Hypotheses $H_{C1}$-$H_{C6}$: When the financial statements are accompanied by the CPA's compilation report, CPAs and bankers share similar views that the statements are:

$H_{C1}$: in conformity with generally accepted accounting principles.

$H_{C2}$: accompanied by all material disclosures.

$H_{C3}$: free from the effects of an existing material unintentional error.

$H_{C4}$: free from the effects of an existing material management fraud.

$H_{C5}$: free from the effects of an existing material employee fraud.

$H_{C6}$: evaluated by a CPA who is independent of management.

Research Question Number 3: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's review report?

Hypotheses $H_{R1}$-$H_{R6}$: When the financial statements are accompanied by the CPA's review report, CPAs and bankers share similar views that the statements are:

$H_{R1}$: in conformity with generally accepted accounting principles.

$H_{R2}$: accompanied by all material disclosures.

$H_{R3}$: free from the effects of an existing material unintentional error.

$H_{R4}$: free from the effects of an existing material management fraud.

$H_{R5}$: free from the effects of an existing material employee fraud.

$H_{R6}$: evaluated by a CPA who is independent of management.

Research Question Number 4: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's audit report?

Hypotheses $H_{A1}$-$H_{A6}$: When the financial statements are accompanied by the CPA's audit report, CPAs and bankers share similar views that the statements are:

$H_{A1}$: in conformity with generally accepted accounting principles.

$H_{A2}$: accompanied by all material disclosures.

$H_{A3}$: free from the effects of an existing material unintentional error.

$H_{A4}$: free from the effects of an existing material management fraud.

$H_{A5}$: free from the effects of an existing material employee fraud.

$H_{A6}$: evaluated by a CPA who is independent of management.

Research Question Number 5: Do users perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Hypotheses $H_{CB1}$-$H_{CB5}$: When the financial statements are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, bankers perceive that the statements are equally:

$H_{CB1}$: in conformity with generally accepted accounting principles.

$H_{CB2}$: accompanied by all material disclosures

$H_{CB3}$: free from the effects of an existing material unintentional error.

$H_{CB4}$: free from the effects of an existing material management fraud.

$H_{CB5}$: free from the effects of an existing material employee fraud.

Hypothesis $H_{CB6}$: When the financial statements are accompanied by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, bankers perceive that the statements are equally:

$H_{CB6}$: evaluated by a CPA who is independent of management.

Research Question Number 6: Do CPAs perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Hypotheses $H_{CP1}$-$H_{CP5}$: When the financial statements are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, CPAs perceive that the statements are equally:

$H_{CP1}$: in conformity with generally accepted accounting principles.

$H_{CP2}$: accompanied by all material disclosures.

$H_{CP}3$: free from the effects of an existing material unintentional error.

$H_{CP4}$: free from the effects of an existing material management fraud.

$H_{CP5}$: free from the effects of an existing material employee fraud.

Hypothesis $H_{CP6}$: When the financial statements are accompanied by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report, CPAs perceive that the statements are equally:

$H_{CP6}$: evaluated by a CPA who is independent of management.

## The Questionnaire

A four-part questionnaire was used to assess the perceptions of randomly selected CPAs and bankers. The questionnaire first presented six questions about the respondents' familiarity with compilations and reviews. These were used to screen appropriate subjects and to assess the extent to which CPAs and bankers were familiar with compilations and reviews. Next, the questionnaire presented a hypothetical loan situation (involving a CPA, the financial statements of a nonpublic business, and a banker) which provided respondents with a common frame of reference. Hypothetical CPA reports (compilation, review, and unqualified audit) depicted increasing levels of assurance about the financial statements, based on increasing degrees of CPA association. The CPAs and bankers rated the six reliability surrogates for the financial statements accompanied by each of the three types of CPA reports. CPAs and bankers also rated five reliability surrogates (excluding CPA independence) for the condition of no CPA report (no association with financial statements). Respondents' perceptions of reliability were measued on a seven-point numerical rating scale with values assigned which ranged from "0" (no confidence) to "6" (complete confidence). A third section of the questionnaire contained demographic questions. Finally, the questionnaire provided space for respondents to write comments about compilations, reviews, and audits.

The construction of the questionnaire and other items in the questionnaire package followed the guidelines set forth by Dillman in Mail and Telephone Surveys.[1] Each questionnaire package included a cover letter, a questionnaire, and a return envelope. Appendix A illustrates the initial cover letters and questionnaire which were mailed to the bankers. Appendix B illustrates the initial cover letter and questionnaire which were mailed to the CPAs. Appendix C illustrates the follow-up cover letters and postcard reminders which were mailed to the CPAs and bankers.

## Questionnaire Bias

Five sources of possible questionnaire bias in the present study were investigated. These were: rating scale errors, sequencing effects of repeated measures, reliability, content validity, and confounding variables.

### Rating Scale Errors

Rating scale errors might have caused questionnaire bias. Three possible errors were leniency, central tendency, and logic. Leniency is a rating scale error which occurs when respondents tend to rate familiar items more favorably than unfamiliar items.[2] In the

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[1] Don A. Dillman (New York: John Wiley and Sons, 1978).

[2] J. P. Guilford, Psychometric Methods, 2nd ed. (New York: McGraw-Hill Book Company, 1954), p. 278.

present study, for example, respondents might have been more familiar with audits than with compilations and reviews, and consequently, might have placed more confidence in audited financial statements than in compiled or reviewed statements. This error was minimized by not using the responses of CPAs or bankers who were unfamiliar with compilations and reviews. Another rating scale error, central tendency, occurs when respondents tend not to use the extreme points of a rating scale.[3] For example, a central tendency error could have occurred in the present study if the respondents did not use the "no confidence" or "complete confidence" ratings. This error was minimized by describing the meaning of each of the seven response categories on the questionnaire. Finally, logic is a rating scale error which occurs when respondents tend to rate similar sounding items similarly.[4] A logic error could have occurred in the present study if respondents rated "free from the effects of an existing material management fraud" and "free from the effects of an existing material employee fraud" similarly because they sound similar. This error was minimized by randomizing the initial ordering of the reliability surrogates.

Sequencing Effects of Repeated Measures

The ordering of the CPA reports contained in the questionnaire represented a possible source of questionnaire bias.[5] The effect of this source of bias was minimized by changing the ordering of the CPA

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[3]Ibid., pp. 278-279.

[4]Ibid., p. 279.

[5]B. J. Winer, Statistical Principles in Experimental Design, 2nd ed. (New York: McGraw-Hill Book Company, 1971), pp. 516-517.

reports in half the questionnaire forms. These forms and ordering of reports were:

1. Form 1: Audit, Compilation, Review, No CPA Association

2. Form 2: Audit, Review, Compilation, No CPA Association

Forms 1 and 2 were sent to an equal number of large bank commercial bank loan officers (CBLOs), small bank chief executive officers (CEOs), and CPAs. ANOVA F-tests were used to test whether these groups responded differently on two forms of the questionnaire, based on combined dependent variable scores. Table 5-1 illustrates the mean scores and F-test results for large bank CBLOs, small bank CEOs, and CPAs. The results indicated that the sample groups did not respond differently on two forms of the questionnaire, based on combined dependent variable scores.

Reliability

Two forms of questionnaire reliability might affect questionnaire bias. These were instrument reliability and subject reliability. Instrument reliability refers to the extent to which the same scores are reproduced when the same questions are measured repeatedly. Subject reliability refers to the extent to which respondents produce consistent scores for similar questions.[6] A common problem of all questionnaire surveys which measure perceptions is the difficulty of investigating these forms of reliability. The use of a questionnaire survey precluded an investigation of instrument and subject reliability in the present research.

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[6]Hugh D. Grove and Richard S. Savich, "Attitude Research in Accounting: A Model for Reliability and Validity Considerations," Accounting Review, July 1979, p. 524.

TABLE 5-1

RESULTS OF ANOVA F-TESTS: SEQUENCING EFFECTS OF REPEATED MEASURES

| Degrees of Association | Large Bank CBLOs Form 1 (n=49) Mean | Large Bank CBLOs Form 2 (n=52) Mean | Large Bank CBLOs F-test Significance | Small Bank CEOs Form 1 (n=13) Mean | Small Bank CEOs Form 2 (n=16) Mean | Small Bank CEOs F-test Significance | CPAs Form 1 (n=55) Mean | CPAs Form 2 (n=65) Mean | CPAs F-test Significance |
|---|---|---|---|---|---|---|---|---|---|
| No CPA Association | 3.1 | 3.4 | .7 | 3.1 | 4.3 | .4 | 1.9 | 2.6 | .3 |
| Compilation | 8.2 | 8.8 | .6 | 8.2 | 7.4 | .6 | 11.9 | 12.1 | .9 |
| Review | 15.0 | 16.9 | .1 | 15.6 | 15.9 | .9 | 19.9 | 20.2 | .8 |
| Audit | 23.6 | 24.8 | .3 | 26.4 | 23.2 | .2 | 27.8 | 28.0 | .8 |

*Significant at .05 or less.

Content Validity

Content validity represented another possible source of questionnaire bias. Content validity refers to (1) the extent to which sampling procedures minimize selection bias and nonresponse bias, and (2) the extent to which respondents understand the contents of the questionnaire.[7] Two steps were taken to minimize questionnaire bias related to content validity. First, the sampling procedures of randomly selecting CPAs, randomly selecting two groups of bankers, and mailing follow-up questionnaires to nonrespondents helped to minimize selection bias and nonresponse bias. (These procedures to minimize sources of bias are further explained in other sections of this chapter.) Second, a pretest of the questionnaire resulted in changes which improved the understandability of its contents. These contents included the hypothetical loan situation, the sample CPA reports, reliability surrogates, and the rating scale response categories. The pretests were performed in October, 1979, by five Michigan practicing CPAs, five Michigan practicing bankers, and five Michigan State University faculty members.

Confounding Variables

Finally, confounding variables were a possible source of questionnaire bias in that they might have biased respondents' ratings of the reliability surrogates. These possible variables pertained to the hypothetical loan situation contained in the questionnnaire. Three possible variables were: the extent of the banker's familiarity with

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[7]Ibid., p. 525.

the client and the client's past financial statements, and the size of the CPA firm.

The respondents' perceptions about the extent of the banker's familiarity with his loan customer and his loan customer's CPA firm might have biased their ratings of the reliability surrogates. If respondents perceived that the banker was familiar with his customer and the CPA firm, then they might have rated all the reliability surrogates favorably without considering the different CPA assurances about the financial statements. To control this possible bias, the loan situation depicted the banker as being unfamiliar with the loan customer and the CPA firm. This depiction, however, might have caused a negative bias in the respondents' ratings. Several banker respondents indicated in written comments on the questionnaire that their ratings of the reliability surrogates were lower as a result of this unfamiliarity.

Respondents' beliefs about the extent of the CPA firm's familiarity with the client and the client's past financial statements might also have confounded the results. If respondents perceived that the CPA firm was associated with past financial statements of the client, then they might have rated all the reliability surrogates favorably without considering the different CPA assurances accompanying the statements. The loan situation controlled this possible bias by depicting the CPA firm as lacking experience with the past financial statements of the client. However, as with the previous variable, this depiction might have caused a negative bias in the respondents' ratings. Written comments from several bank respondents indicated that their ratings of the reliability surrogates were lower as a result of this unfamiliarity.

Finally, respondents' perceptions about the size of the CPA firm might have biased their ratings of the reliability surrogates. If respondents believed that the CPA firm was a large international firm and also believed that larger firms consistently outperformed smaller firms, then they might have rated the reliability surrogates higher. To control this possible bias, the loan situation depicted the CPA firm as reputable without referring to the size of the firm. As a result of this depiction, respondents might have perceived that the CPA firm was a smaller firm, and consequently, might have rated the reliability surrogates lower. Several CPA respondents indicated in written comments that they believed that the CPA firm was a smaller firm, and that they rated the reliability surrogates lower.

The following sources of possible questionnaire bias in the present study were investigated: rating scale errors, sequencing effects of repeated measures, reliability, content validity, and confounding variables. In light of the actions taken to minimize questionnaire bias, such bias was not considered a significant problem in the present study.

## Bankers

This section discusses the two sample groups of bankers with respect to sample selection, response analysis, and nonresponse bias. Appendix D includes selected demographic characteristics of the bank respondents.

Sample Selection

Michigan practicing bankers comprised the target and sample banker populations. Because a single listing of all Michigan bankers did not exist, a sampling plan was devised to establish two sampling frames according to bank sizes. Using Michigan National Corporation's 1979 Michigan Bank Directory, the total number of Michigan banks (364) was divided into (1) 70 large banks (the total assets of which were greater than $100 million per bank), and (2) 294 small banks (the total assets of which were less than $100 million per bank).

The first sampling frame was a list of 578 commercial bank loan officers (CBLOs) who worked for the 70 largest Michigan banks. This list contained 534 CBLOs who were named in the Robert Morris Associates' 1979-1980 Membership Roster, and 44 CBLOs who were not members of Robert Morris Associates. Telephone calls were made to thirteen banks who were not members of Robert Morris Associates in order to list these 44 CBLOs. A random sample of 130 CBLOs was then drawn from this frame without replacement.

The second sampling frame was a list of the chief executive officers (CEOs) of the 294 small banks. A random sample of 70 banks was drawn from this frame without replacement. Then, using the 1979 Michigan Bank Directory for addresses, a questionnaire was mailed to the CEO of each selected bank. Each CEO was asked to complete the questionnaire or to delegate a loan officer to complete the questionnaire. In a few cases other bankers replied on behalf of the targeted CEOs.

A possible source of selection bias was the manner in which the sampling plan for bankers divided them into two different groups.

These were CBLOs from the 70 largest Michigan banks, and CEOs representing the 294 smallest Michigan banks. Because these two groups represent different units of statistical analysis, they were not combined to formulate generalizations about the population of Michigan practicing bankers. As a result, the research hypotheses related to bankers were tested separately for CBLOs and CEOs.

## Response Analysis

Questionnaires were mailed to 130 CBLOs and to 70 CEOs on November 26, 1979. A postcard reminder was sent to these groups on December 3, 1979. A second questionnaire was mailed to all nonrespondents on December 17, 1979. A third mailing was sent to all nonresponding CBLOs on January 24, 1980. Finally, telephone calls were made to all nonresponding CEOs on February 11-12, 1980. Tables 5-2 and 5-3 summarize the response analysis. Telephone responses were not counted in this analysis. Bankers who answered "no" to all six questions about familiarity with compilations and reviews were considered to be unfamiliar with compilations and reviews. As a result, these bankers were counted as inappropriate subjects and their responses were not included in tests of the research hypotheses.

## Nonresponse Bias

Possible nonresponse bias of the sample groups of CBLOs and CEOs was investigated by (1) follow-up procedures on the initial mailing of questionnaires, (2) statistical comparisons of banker responses by time period of response, and (3) telephone calls to nonresponding small bank CEOs.

Follow-up procedures on the initial mailing of questionnaires

TABLE 5-2

BANKER RESPONSES TO MAILINGS

| | Number of Large Bank CBLOs | Number of Small Bank CEOs |
|---|---|---|
| Bankers in Sample Groups | 130 | 70 |
| Inappropriate Bankers* | 5 | 9 |
| Appropriate Bankers | 125 | 61 |
| Responses to First Mailing | 79 | 11 |
| Responses to Second Mailing | 14 | 18 |
| Responses to Third Mailing | 8 | - |
| Total Responses | 101 | 29 |
| Response Percentage | 80.8 | 47.5 |

*See Table 5-3 for the analysis of inappropriate bankers

TABLE 5-3

ANALYSIS OF INAPPROPRIATE BANKER RESPONSES

| | Number of Large Bank CBLOs | Number of Small Bank CEOs |
|---|---|---|
| Not Familiar with Compilations and Reviews | 4 | 6 |
| Bank's or Individual's Policy Not to Respond to Surveys | 1 | 2 |
| Partially Completed Questionnaire | - | 1 |
| Total | 5 | 9 |

reduced possible nonresponse bias by increasing the response rates for large bank CBLOs and for small bank CEOs. These procedures included a postcard reminder mailed to the sample groups one week after the initial mailing, a second questionnaire mailed to nonrespondents three weeks after the initial mailing, and a third questionnaire mailed to large bank nonrespondents eight weeks after the initial mailing.

ANOVA F-tests were used to test whether the early respondents and late respondents answered the questionnaire differently, based on combined dependent variable scores. These tests were performed for large bank CBLOs with respect to four degrees of association and three mailings of the questionnaire, and for small bank CEOs with respect to four degrees of association and two mailings. Tables 5-4 and 5-5 illustrate the mean scores and F-test results for the respective groups, CBLOs and CEOs. The results indicated that both early respondents and late respondents did not answer the questionnaire differently, based on combined dependent variable scores.

Finally, telephone calls to the CEOs of nonresponding small banks were made in order to investigate possible nonresponse bias in this sample group. In these calls, the CEOs or their delegated representatives responded to the six questions about familiarity with compilations and reviews, and to a general question on their concerns about the research. Table 5-6 compares small bank CEOs who responded by mail to small bank CEOs who were contacted by telephone with respect to responses to the six familiarity questions. As shown by these comparisons, the CEOs who were contacted by telephone were not quite as familiar with compilations and reviews as the CEOs who returned questionnaires. Therefore, a nonresponse bias might be possible because

TABLE 5-4

RESULTS OF ANOVA F-TESTS: LARGE BANK CBLO RESPONSES BY TIME PERIODS

| Degrees of Association | First Mailing (n=79) Mean | Second Mailing (n=14) Mean | Third Mailing (n=8) Mean | F-Test Significance |
|---|---|---|---|---|
| No CPA Association | 3.3 | 2.9 | 3.3 | .9 |
| Compilation | 8.0 | 9.3 | 12.1 | .1 |
| Review | 15.6 | 16.9 | 18.3 | .3 |
| Audit | 23.7 | 25.8 | 26.6 | .2 |

*Significant at .05 or less

TABLE 5-5

RESULTS OF ANOVA F-TESTS: SMALL BANK CEO RESPONSES BY TIME PERIODS

| Degrees of Association | First Mailing (n=11) Mean | Second Mailing (n=18) Mean | F-Test Significance |
|---|---|---|---|
| No CPA Association | 3.3 | 4.0 | .6 |
| Compilation | 9.2 | 6.9 | .2 |
| Review | 15.1 | 16.2 | .6 |
| Audit | 24.3 | 24.8 | .9 |

*Significant at .05 or less

TABLE 5-6

COMPARISONS OF SMALL BANK CEOS RESPONDING BY MAIL AND BY TELEPHONE:
FAMILIARITY WITH COMPILATIONS AND REVIEWS

| Familiarity Questions | Percentage of Mail Respondents (n=35) Answering "Yes" | Percentage of Telephone Respondents (n=29) Answering "Yes" |
|---|---|---|
| Have you read any materials about compilations and reviews? | 51.4% | 34.5% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by your bank? | 2.9% | 0.0% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by an organization other than your bank? | 17.1% | 6.9% |
| Have you seen a CPA's compilation report accompanying the financial statements of any of your bank's customers? | 54.3% | 51.7% |
| Have you seen a CPA's review report accompanying the financial statements of any of your bank's customers? | 45.7% | 31.0% |
| Do you now use or expect to use in the future compilation reports or review reports prepared by CPAs? | 68.6% | 55.2% |

Note: The percentages in this table are sample percentages and, therefore, are subject to sample variability. The standard error of a sample percentage is approximately 50% divided by the square root of the sample size.

nonresponding small bank CEOs were not quite as familiar with compilations and reviews as responding small bank CEOs were.

## Certified Public Accountants

This section discusses the sample group of CPAs with respect to sample selection, response analysis, and nonresponse bias. Appendix E includes selected demographic characteristics of the CPA respondents.

### Sample Selection

Michigan practicing CPAs comprised the target CPA population. Michigan practicing CPAs who were members of the Michigan Association of Certified Public Accountants (MACPA) comprised the sample population. The sampling frame was MACPA's 1979 Membership Directory, which listed 3,714 practicing CPAs (after deleting CPAs who worked for government, education, or business organizations). A random sample of 200 CPAs was drawn from this frame without replacement.

### Response Analysis

Questionnaires were mailed to 200 CPAs on November 26, 1979. A postcard reminder was sent to these CPAs on December 3, 1979. A second questionnaire was mailed to all nonrespondents on December 17, 1979. Finally, a third mailing was sent to all nonrespondents on January 24, 1980. Tables 5-7 and 5-8 summarize the response analysis. CPAs who answered "no" to all six questions about familiarity with compilations and reviews were considered to be unfamiliar with compilations and reviews. As a result, these CPAs were counted as inappropriate subjects and their responses were not included in tests of the research hypotheses.

TABLE 5-7

CPA RESPONSES TO MAILINGS

| | Number of CPAs |
|---|---|
| CPAs in Sample Group | 200 |
| Inappropriate CPAs* | 20 |
| Appropriate CPAs | 180 |
| Responses to First Mailing | 75 |
| Responses to Second Mailing | 32 |
| Responses to Third Mailing | 13 |
| | 120 |
| Response Percentage | 66.7 |

*See Table 5-8 for the analysis of inappropriate CPAs

TABLE 5-8

ANALYSIS OF INAPPROPRIATE CPA RESPONSES

| | Number of CPAs |
|---|---|
| Not Familiar with Compilations and Reviews | 2 |
| Firm's or Individual's Policy Not to Respond to Surveys | 3 |
| No Longer in Public Accounting | 13 |
| Undeliverable | 2 |
| Total | 20 |

## Nonresponse Bias

Possible nonresponse bias of the sample group of CPAs was investigated by (1) follow-up procedures on the initial mailing of questionnaires and (2) statistical comparisons of CPA responses by time period of response.

Follow-up procedures on the initial mailing of questionnaires reduced possible nonresponse bias by increasing the response rate for CPAs. These procedures included a postcard reminder mailed to the sample group one week after the initial mailing, a second questionnaire mailed to nonrespondents three weeks after the initial mailing, and a third questionnaire mailed to nonrespondents eight weeks after the initial mailing.

ANOVA F-tests were used to test whether the early respondents and late respondents answered the questionnaire differently, based on combined dependent variable scores. These tests were performed on four degrees of association and three mailings of the questionnaire. Table 5-9 illustrates the mean scores and F-test results. The results indicated that both early and late CPA respondents did not answer the questionnaire differently, based on combined dependent variable scores.

## Statistical Analyses

This section describes the statistical design, multivariate model, multivariate data analysis, and univariate test statistics, which were used to test the research hypotheses. The section also discusses the assumptions of the multivariate and univariate statistical models.

TABLE 5-9

RESULTS OF ANOVA F-TESTS: CPA RESPONSES BY TIME PERIODS

| Degrees of Association | First Mailing (n=75) Mean | Second Mailing (n=32) Mean | Third Mailing (n=13) Mean | F-test Significance |
|---|---|---|---|---|
| No CPA Association | 2.2 | 2.6 | 2.0 | .8 |
| Compilation | 11.9 | 13.0 | 10.5 | .4 |
| Review | 20.1 | 20.4 | 18.5 | .5 |
| Audit | 28.2 | 27.4 | 27.5 | .6 |

*Significant at .05 or less

Statistical Design

Two repeated measures parametric F-tests were used to test the research hypotheses. Repeated measures tests were used because each subject responded to each dependent variable for each degree of association. Parametric statistical models were chosen despite the ordinal scale properties of the rating scales contained in the questionnaire. Some researchers believe that parametric tests (e.g. F-tests and t-tests) should not be applied to ordinal scale data because the data fails to meet required assumptions of independence, distribution normality, and variance equality. Instead, these researchers would apply nonparametric tests to this data.[8] But because the failure to meet parametric data assumptions does not usually affect the results anyway, this researcher chose to apply parametric tests to ordinal scale data. Gardner supported this position when he stated that parametric tests are highly robust and that treating ordinal data as interval data would not normally lead the researcher to improper conclusions.[9] Furthermore, it was believed that parametric F-tests and t-tests used in the present study were more powerful and more easily used than similar nonparametric tests.

One repeated measures F-test was a multivariate test which was used to test hypotheses with respect to five dependent variables (reliability surrogates). These hypotheses were those identified as: $H_{N1}$ through $H_{N5}$, $H_{C1}$ through $H_{C5}$, $H_{R1}$ through $H_{R5}$, $H_{A1}$ through $H_{A5}$, $H_{CB1}$

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[8]Paul L. Gardner, "Scale and Statistics," Review of Educational Research, Winter 1975, pp. 43-45.

[9]Ibid., p. 51.

through $H_{CB5}$, and $H_{CP1}$ through $H_{CP5}$. Figure 5-1 illustrates the two-by-four multivariate repeated measures design. This design contained three sets of independent factors and five dependent variables. CPAs and bankers comprised the fixed group factor. Next, a randomly selected number of subjects were nested within each group. Four degrees of association comprised another independent factor. These degrees, shown in Figure 5-1, were: no CPA association, compilation, review, and audit. Finally, the five dependent variables, represented by $V_1$ through $V_5$ in Figure 5-1, measured the extent to which respondents perceive that financial statements are (1) in conformity with generally accepted accounting principles, (2) accompanied by all material disclosures, (3) free from the effects of an existing material unintentional error, (4) free from the effects of an existing material management fraud, and (5) free from the effects of an existing material employee fraud.

Another repeated measures F-test was used to test hypotheses with respect to one dependent variable. These hypotheses were those identified as: $H_{C6}$, $H_{R6}$, $H_{A6}$, $H_{CB6}$, and $H_{CP6}$. Figure 5-2 illustrates the two-by-three repeated measures design. Compared to the two-by-four design, this design contained the same sets of fixed group and random subjects factors, but excluded "no CPA association" from the degree of association factor. In addition, this design contained one dependent variable, represented by $V_6$ in Figure 5-2, which measured the extent to which respondents perceived that financial statements are evaluated by a CPA who is independent of management.

| | SUBJECTS | NO CPA ASSOCIATION | COMPILATION | REVIEW | AUDIT |
|---|---|---|---|---|---|
| | | $V_1$ .. $V_5$* | $V_1$ .. $V_5$ | $V_1$ .. $V_5$ | $V_1$ .. $V_5$ |
| BANKERS | $S_{11}$<br>$S_{12}$<br>.<br>.<br>.<br>$S_{1n_1}$ | | | | |
| CPAs | $S_{21}$<br>$S_{22}$<br>.<br>.<br>.<br>$S_{2n_2}$ | | | | |

*where:

$V_1$ = in conformity with generally accepted accounting principles
$V_2$ = accompanied by all material disclosures
$V_3$ = free from the effects of an existing material unintentional error
$V_4$ = free from the effects of an existing material management fraud
$V_5$ = free from the effects of an existing material employee fraud

Fig. 5-1. Two-by-four multivariate repeated measures design

| | SUBJECTS | COMPILATION $V_6$* | REVIEW $V_6$ | AUDIT $V_6$ |
|---|---|---|---|---|
| BANKERS | $S_{11}$<br>$S_{12}$<br>.<br>.<br>.<br>$S_{1n_1}$ | | | |
| CPAs | $S_{21}$<br>$S_{22}$<br>.<br>.<br>.<br>$S_{2n_2}$ | | | |

*where:
$V_6$ = evaluated by a CPA who is independent of management

Fig. 5-2. Two-by-three repeated measures design

Multivariate Model

The parametric multivariate model used in the present research was a linear statistical model, which was applied to each dependent variable:[10]

$$Y_{ijk} = \mu + \alpha_{ij} + \beta_j + \gamma_k + (\beta\gamma)_{jk} + \varepsilon_{ijk}$$

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[10] R. Darrell Bock, Multivariate Statistical Methods in Behavioral Research (New York: McGraw-Hill Book Company, 1975), pp. 470-471.

where:

$Y_{ijk}$ = score of subject i, in group j, responding to degree of association k

$\mu$ = arbitrary location constant

$\alpha_{ij}$ = individual difference component for subject i in group j

$\beta_j$ = main effect of group j

$\gamma_k$ = main effect of degree of association k

$(\beta\gamma)_{jk}$ = interactive effect of group j on degree of association k

$\varepsilon_{ijk}$ = error component of subject i in group j on degree of association k

The model's parametric assumptions were:

1. $\alpha_{ij} \sim N(0, \sigma^2)$

2. The vectors $\varepsilon_{ij} = (\varepsilon_{ij1}, \varepsilon_{ij2}, \varepsilon_{ij3}, \varepsilon_{ij4})$ were independent, each with a multivariate normal distribution with a zero mean vector, and equal covariance matrices for all i's and j's.

Another restriction was:

$$\sum_j \beta j = \sum_k \gamma k = \sum_j (\beta\gamma)_{jk} = \sum_k (\beta\gamma)_{jk} = 0$$

The following statistical null hypotheses were tested for each dependent variable:

1. $(\beta\gamma)_{jk} = 0$ for all j's and k's; there were no group-by-degree of association interaction.

2. $\beta_j = 0$ for all j's; there were no group main effects.

3. $\gamma_k = 0$ for all k's; there were no degree of association main effects.

Multivariate Data Analysis

The data collected were transferred to computer input for the FINN program, "Multivariate Repeated Measures ANOVA.[11] One program tested hypotheses related to dependent variables $V_1$ through $V_5$. Another program tested hypotheses pertaining to dependent variable $V_6$. The initial step in the analysis tested for group-by-degree of association interaction on the dependent variables. If interaction appeared to be statistically insignificant, then group and degree of association main effects were meaningfully evaluated. If at least one dependent variable was affected by significant interaction, then individual univariate t-tests were performed to test the research hypotheses.

Univariate Test Statistics

The data collected were transferred to computer input for the SPSS program, "Subprogram T-test: Comparison of Sample Means.[12] Two forms of this program were used to test the research hypotheses, namely, "Comparison of Means--Independent Samples" and "Paired Samples."

First, the statistical test, "Comparison of Means--Independent Samples" was used to test research hypotheses $H_{N1}$ through $H_{N5}$, $H_{C1}$ through $H_{C5}$, $H_{R1}$ through $H_{R5}$, and $H_{A1}$ through $H_{A5}$. This test computed CPA-banker mean score differences with respect to specific reliability surrogates and degrees of CPA association. For example, the test

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[11] Jeremy D. Finn, A General Model for Multivariate Analysis (New York: Holt, Rinehart and Winston, Inc., 1974); William Schmidt and Verda Scheifley, "Jeremy D. Finn's Multivariance," (Occasional Paper Number 22 [East Lansing, Michigan: Office of Research Consultation, Michigan State University, 1973]).

[12] Norman H. Nie, Statistical Package for the Social Sciences, 2nd ed. (New York: McGraw-Hill Book Company, 1975), pp. 267-274.

evaluated whether CPAs and bankers shared similar views that compiled financial statements were in conformity with generally accepted accounting principles ($H_{C1}$). An appropriate t-statistic for these tests was:

$$t = \frac{(\bar{x}_1 - \bar{x}_2)}{\sqrt{\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}}}$$

where:

$t$ = test statistic value
$\bar{x}_1$ = sample mean score of group 1
$\bar{x}_2$ = sample mean score of group 2
$s_1^2$ = sample variance of group 1
$s_2^2$ = sample variance of group 2
$n_1$ = sample size of group 1
$n_2$ = sample size of group 2

Under the null hypotheses tested, this t-statistic has an approximate standard normal distribution for large sized sample groups.

Second, the statistical test, "Paired Samples" was used to test research hypotheses $H_{CB1}$ through $H_{CB5}$, and $H_{CP1}$ through $H_{CP5}$. This test computed degree of association mean score differences with respect to specific reliability surrogates and respondent groups. For example, the test evaluated whether CPAs perceive differences between the reliability of financial statements accompanied by the CPA's compilation report and by the CPA's review report, on the basis that the financial statements were accompanied by all material disclosures ($H_{CP2}$). An appropriate t-statistic for these tests was:

$$t = \frac{\bar{d}}{\frac{s_d}{\sqrt{n}}}$$

where:

$t$ = test statistic value

$d_i$ = difference in observations made in pairs $(x_{1i}-x_{2i})$ for $i = 1, 2, \ldots n$ observations

$S_d^2$ = sample variance of $d_i$.

Under the null hypotheses tested, this t-statistic has a t-distribution with n-1 degrees of freedom if the normality assumptions of $\varepsilon_{ijk}$ hold.

## Assumptions of the Models

The assumptions of the statistical models described above could not hold exactly. For example, the $\varepsilon_{ij}$ referred to in the multivariate model could not have normal distributions because the observations measured in the present study were discrete. Since these models were idealizations, it was believed that they would generally hold so that the conclusions, stated in probabilities, would be approximately correct. In the present study, the sample sizes were large enough for the researcher to believe that the probability statements were good approximations of their true values. For example, if a test of a null hypothesis were significant at the .03 level, then the true significance level might be .01 or .05, but probably would not have been .001 or .10.

## Summary

This chapter described the methodology used in the present research to test the effectiveness of the communication process between CPAs and bankers. Methodological topics described were: the research questions and research hypotheses; the questionnaire; questionnaire bias; the sample groups of bankers; the sample group of CPAs; and statistical analyses. Three types of possible bias related to the methodology were investigated in this chapter: (1) questionnaire bias, (2) selection bias, and (3) nonresponse bias. First, precautions were taken in the design of the questionnaire to minimize possible questionnaire bias. Second, the random sampling of practicing bankers from both large banks and small banks, and the random sampling of practicing CPAs minimized possible selection bias. Finally, response rates and statistical comparisons of early and late respondents were used to determine that respondents did not differ from nonrespondents in any significant respects. The chapter also described the statistical design of the present research. As part of this design, the chapter explained how multivariate repeated measures F-tests and univariate t-tests were used to test the research hypotheses.

The next chapter presents the data and results of statistical tests used to assess the effectiveness of the CPA-user communication process.

# CHAPTER VI

## RESULTS

This chapter presents the data and results of statistical tests used in the present study to assess the effectiveness of the communication between certified public accountants (CPAs) and bankers. The chapter first describes the respondents' ratings of the six reliability surrogates in terms of mean scores and standard errors of these scores. The six reliability surrogates refer to the extent to which financial statements are (1) in conformity with generally accepted accounting principles (GAAP), (2) accompanied by all material disclosures (disclosures), (3) free from the effects of an existing material unintentional error (unintentional error), (4) free from the effects of an existing material management fraud (management fraud), (5) free from the effects of an existing material employee fraud (employee fraud), and (6) evaluated by a CPA who is independent of management (independence). Then, the chapter discusses the results in terms of four categories: group effects, degree of association effects, reliability surrogate effects, and familiarity effects. One section of the chapter describes group effects, which refer to the similarities with which CPAs as a group and bankers as a group perceive assurances about the reliability of financial statements. Another section reports degree of association effects. These are defined as the extent to which respondents perceive different assurances about the reliability of financial statements

accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. Then, a section describes reliability surrogate effects. These effects refer to the respondents' relative evaluations of the reliability surrogates for each degree of association. The final section of the chapter describes familiarity effects, or the extent to which respondent groups are familiar with compilations and reviews.

## Mean Scores and Standard Errors

Respondents' perceptions of the reliability of financial statements are summarized in Table 6-1 by mean scores and standard errors of these scores. This table shows both the mean scores and standard errors of each group's ratings of the reliability surrogates for each degree of association. Respondents indicated these ratings on the questionnaire by marking one of the seven responses following each reliability surrogate. The response categories and numerical values assigned were: no confidence, 0; very weak confidence, 1; weak confidence 2; medium confidence, 3; strong confidence, 4; very strong confidence, 5; and complete confidence, 6. The mean scores of each group were computed by adding the numerical values of the responses, and dividing these sums by the number of responses. The standard errors of these mean scores were then computed by dividing the standard deviation of each mean score by the square root of the sample size. The mean scores were further used to (1) plot the graphs in Figures 6-1 through 6-16, and (2) statistically assess group effects, degree of association effects, and reliability surrogate effects.

TABLE 6-1

RESULTS OF MEAN SCORES AND STANDARD ERRORS

| Degrees of Association and Reliability Surrogates | Large Bank CBLOs (n=101) | | Small Bank CEOs (n=29) | | CPAs (n=120) | |
|---|---|---|---|---|---|---|
| | Mean | Standard Error | Mean | Standard Error | Mean | Standard Error |
| **No CPA Association** | | | | | | |
| GAAP | .9 | .09 | .8 | .17 | .5 | .08 |
| Disclosures | .5 | .07 | .6 | .15 | .3 | .06 |
| Unintentional Error | .8 | .08 | .9 | .14 | .6 | .08 |
| Management Fraud | .6 | .07 | .7 | .16 | .4 | .07 |
| Employment Fraud | .5 | .07 | .8 | .15 | .5 | .07 |
| **Compilation** | | | | | | |
| GAAP | 1.9 | .13 | 1.6 | .21 | 2.6 | .13 |
| Disclosures | 1.0 | .10 | 1.0 | .16 | 1.8 | .14 |
| Unintentional Error | 1.5 | .12 | 1.3 | .16 | 1.8 | .12 |
| Management Fraud | 1.0 | .10 | .9 | .14 | 1.2 | .11 |
| Employee Fraud | .9 | .10 | 1.0 | .17 | 1.1 | .10 |
| Independence | 2.1 | .18 | 2.0 | .30 | 3.4 | .17 |
| **Review** | | | | | | |
| GAAP | 3.2 | .10 | 3.2 | .15 | 4.0 | .11 |
| Disclosures | 2.4 | .10 | 2.3 | .20 | 3.5 | .11 |
| Unintentional Error | 2.7 | .10 | 2.5 | .19 | 3.3 | .11 |
| Management Fraud | 2.2 | .11 | 2.3 | .22 | 2.4 | .11 |
| Employee Fraud | 2.0 | .11 | 2.2 | .19 | 2.3 | .11 |
| Independence | 3.4 | .13 | 3.3 | .26 | 4.6 | .11 |
| **Audit** | | | | | | |
| GAAP | 4.5 | .10 | 4.6 | .23 | 5.2 | .08 |
| Disclosures | 4.0 | .11 | 3.9 | .22 | 5.0 | .09 |
| Unintentional Error | 4.1 | .10 | 4.0 | .22 | 4.8 | .09 |
| Management Fraud | 3.6 | .11 | 3.8 | .25 | 3.8 | .10 |
| Employee Fraud | 3.6 | .12 | 3.9 | .24 | 3.8 | .11 |
| Independence | 4.4 | .12 | 4.4 | .20 | 5.3 | .07 |

## Group Effects

Group effects related to the following research questions (for corresponding research hypotheses, see Chapter V):

Research Question Number 1: Do CPAs and users share similar views about the reliability of financial statements when there is no CPA association with the statements?

Research Question Number 2: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's compilation report?

Research Question Number 3: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's review report?

Research Question Number 4: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's audit report?

This section first reports the mean score results pertaining to group effects in both tabular and graphic forms. Then, the results of multivariate and univariate statistical tests of the research hypotheses are presented. Finally, the meaning of these results is discussed.

### Results

The mean score results of group effects are shown in the first two columns of Tables 6-2 and 6-3. Table 6-2 compares the perceptions of CPAs to those of large bank CBLOs. Table 6-3 compares the perceptions of CPAs to small bank CEOs. Figures 6-1 through 6-6 graphically illustrate these respondent groups' mean scores for each reliability surrogate.

Four repeated measures F-tests and forty univariate t-tests were used to test the research hypotheses associated with group effects. These hypotheses were identified as: $H_{N1}$ through $H_{N5}$, $H_{C1}$ through $H_{C6}$, $H_{R1}$ through $H_{R6}$, and $H_{A1}$ through $H_{A6}$.

TABLE 6-2

RESULTS OF GROUP EFFECTS: LARGE BANK CBLO AND CPA COMPARISONS

| Degrees of Association and Reliability Surrogates | Large Bank CBLOs (n=101) Mean | CPAs (n=120) Mean | T-value | Two-tailed Significance Probability | Hypothesis | Decision |
|---|---|---|---|---|---|---|
| No CPA Association | | | | | | |
| GAAP | .9 | .5 | 3.02 | .003 | $H_{N1}$ | Accept |
| Disclosures | .5 | .3 | 1.51 | .131 | $H_{N2}$ | Accept |
| Unintentional Error | .8 | .6 | 2.24 | .026 | $H_{N3}$ | Accept |
| Management Fraud | .6 | .4 | 1.46 | .147 | $H_{N4}$ | Accept |
| Employee Fraud | .5 | .5 | .56 | .577 | $H_{N5}$ | Accept |
| Compilation | | | | | | |
| GAAP | 1.9 | 2.6 | -4.10 | .000* | $H_{C1}$ | Reject |
| Disclosures | 1.0 | 1.8 | -4.39 | .000* | $H_{C2}$ | Reject |
| Unintentional Error | 1.5 | 1.8 | -2.00 | .047 | $H_{C3}$ | Accept |
| Management Fraud | 1.0 | 1.2 | -1.10 | .274 | $H_{C4}$ | Accept |
| Employee Fraud | .9 | 1.1 | -1.19 | .237 | $H_{C5}$ | Accept |
| Independence | 2.1 | 3.4 | -- | -- | $H_{C6}$ | Reject** |
| Review | | | | | | |
| GAAP | 3.2 | 4.0 | -5.56 | .000* | $H_{R1}$ | Reject |
| Disclosures | 2.4 | 3.5 | -6.81 | .000* | $H_{R2}$ | Reject |
| Unintentional Error | 2.7 | 3.3 | -3.52 | .001* | $H_{R3}$ | Reject |
| Management Fraud | 2.2 | 2.4 | - .91 | .366 | $H_{R4}$ | Accept |
| Employee Fraud | 2.0 | 2.3 | -1.72 | .087 | $H_{R5}$ | Accept |
| Independence | 3.4 | 4.6 | -- | -- | $H_{R6}$ | Reject** |
| Audit | | | | | | |
| GAAP | 4.5 | 5.2 | -5.88 | .000* | $H_{A1}$ | Reject |
| Disclosures | 4.0 | 5.0 | -6.67 | .000* | $H_{A2}$ | Reject |
| Unintentional Error | 4.1 | 4.8 | -5.24 | .000* | $H_{A3}$ | Reject |
| Management Fraud | 3.6 | 3.8 | -1.37 | .172 | $H_{A4}$ | Accept |
| Employee Fraud | 3.6 | 3.8 | -1.38 | .169 | $H_{A5}$ | Accept |
| Independence | 4.4 | 5.3 | -- | -- | $H_{A6}$ | Reject** |

*Null hypothesis rejected at a significance level of .001 or less

**Null hypothesis rejected as a result of repeated measures F-test

TABLE 6-3

RESULTS OF GROUP EFFECTS: SMALL BANK CEO AND CPA COMPARISONS

| Degrees of Association and Reliability Surrogates | Small Bank CEOs (n=29) Mean | CPAs (n=120) Mean | T-value | Two-tailed Significance Probability | Hypothesis | Decision |
|---|---|---|---|---|---|---|
| No CPA Association | | | | | | |
| GAAP | .8 | .5 | 1.57 | .123 | $H_{N1}$ | Accept |
| Disclosures | .6 | .3 | 1.67 | .103 | $H_{N2}$ | Accept |
| Unintentional Error | .9 | .6 | 1.89 | .065 | $H_{N3}$ | Accept |
| Management Fraud | .7 | .4 | 1.58 | .121 | $H_{N4}$ | Accept |
| Employee Fraud | .8 | .5 | 1.76 | .085 | $H_{N5}$ | Accept |
| Compilation | | | | | | |
| GAAP | 1.6 | 2.6 | -4.27 | .000* | $H_{C1}$ | Reject |
| Disclosures | 1.0 | 1.8 | -3.84 | .000* | $H_{C2}$ | Reject |
| Unintentional Error | 1.3 | 1.8 | -2.73 | .008 | $H_{C3}$ | Accept |
| Management Fraud | .9 | 1.2 | -1.73 | .088 | $H_{C4}$ | Accept |
| Employee Fraud | 1.0 | 1.1 | - .72 | .473 | $H_{C5}$ | Accept |
| Independence | 2.0 | 3.4 | -- | -- | $H_{C6}$ | Reject** |
| Review | | | | | | |
| GAAP | 3.2 | 4.0 | -4.51 | .000* | $H_{R1}$ | Reject |
| Disclosures | 2.3 | 3.5 | -5.12 | .000* | $H_{R2}$ | Reject |
| Unintentional Error | 2.5 | 3.3 | -3.60 | .001* | $H_{R3}$ | Reject |
| Management Fraud | 2.3 | 2.4 | - .46 | .648 | $H_{R4}$ | Accept |
| Employee Fraud | 2.2 | 2.3 | - .25 | .807 | $H_{R5}$ | Accept |
| Independence | 3.3 | 4.6 | -- | -- | $H_{R6}$ | Reject** |
| Audit | | | | | | |
| GAAP | 4.6 | 5.2 | -2.89 | .007 | $H_{A1}$ | Accept |
| Disclosures | 3.9 | 5.0 | -4.39 | .000* | $H_{A2}$ | Reject |
| Unintentional Error | 4.0 | 4.8 | -3.48 | .001* | $H_{A3}$ | Reject |
| Management Fraud | 3.8 | 3.8 | .25 | .806 | $H_{A4}$ | Accept |
| Employee Fraud | 3.9 | 3.8 | .39 | .698 | $H_{A5}$ | Accept |
| Independence | 4.4 | 5.3 | -- | -- | $H_{A6}$ | Reject** |

*Null hypothesis rejected at a significance level of .001 or less

**Null Hypothesis rejected as a result of repeated measures F-test

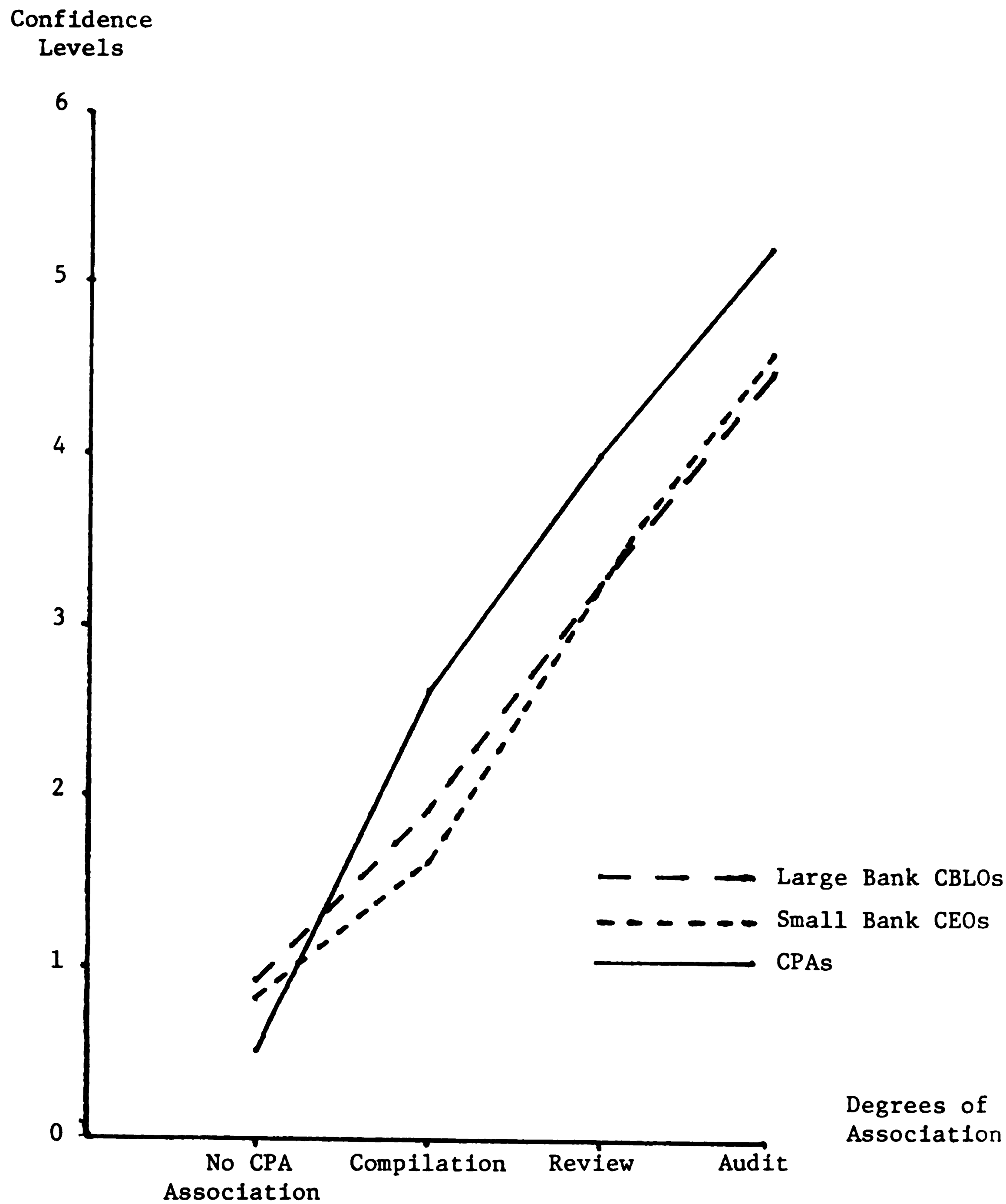



Fig. 6-1. Graph of mean scores for group effects: GAAP.

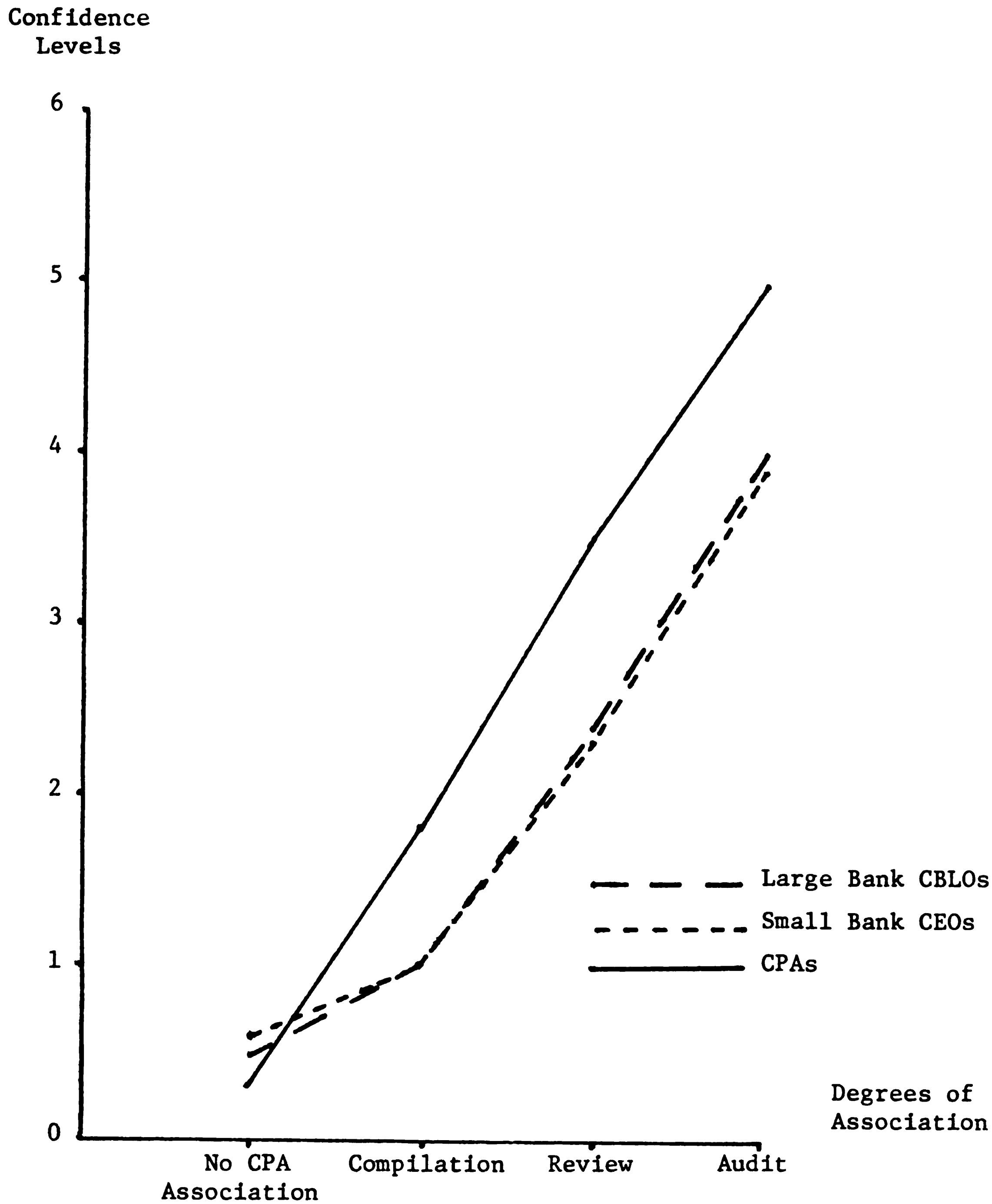



Fig. 6-2. Graph of mean scores for group effects: disclosures.

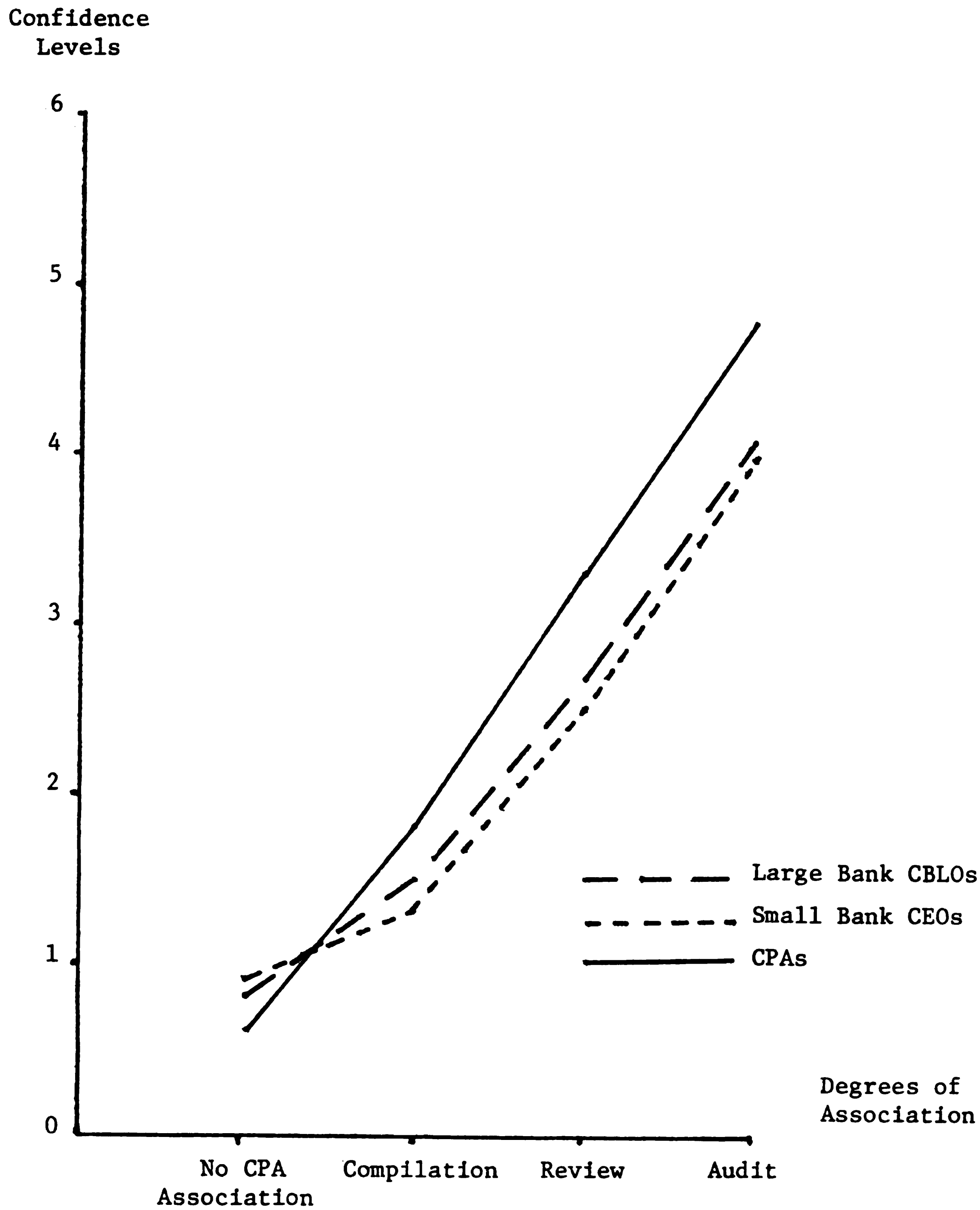
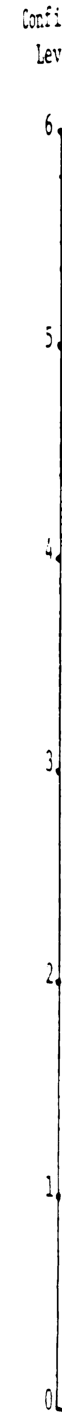



Fig. 6-3. Graph of mean scores for group effects: unintentional error.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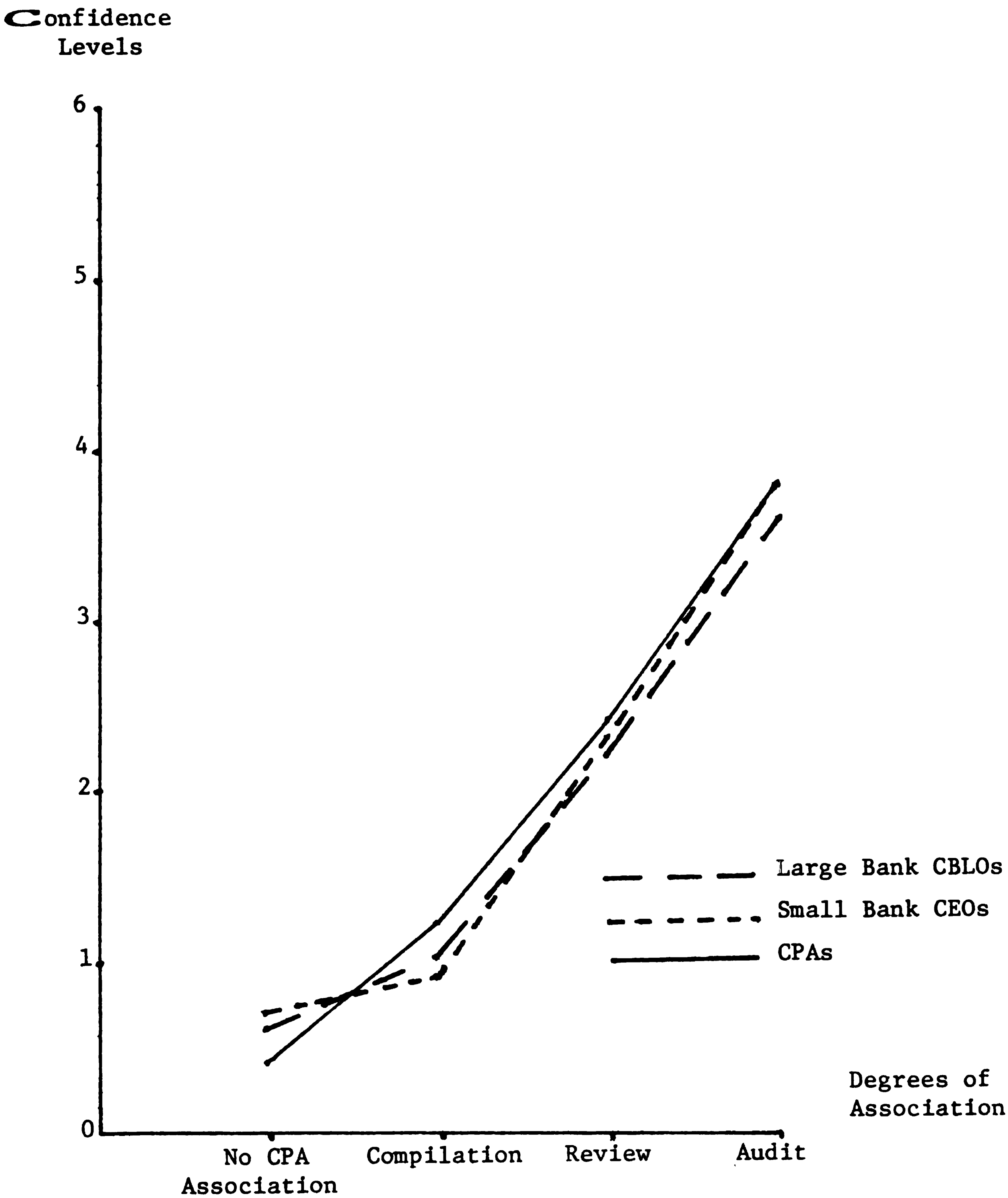


Fig. 6-4. Graph of mean scores for group effects: management fraud.

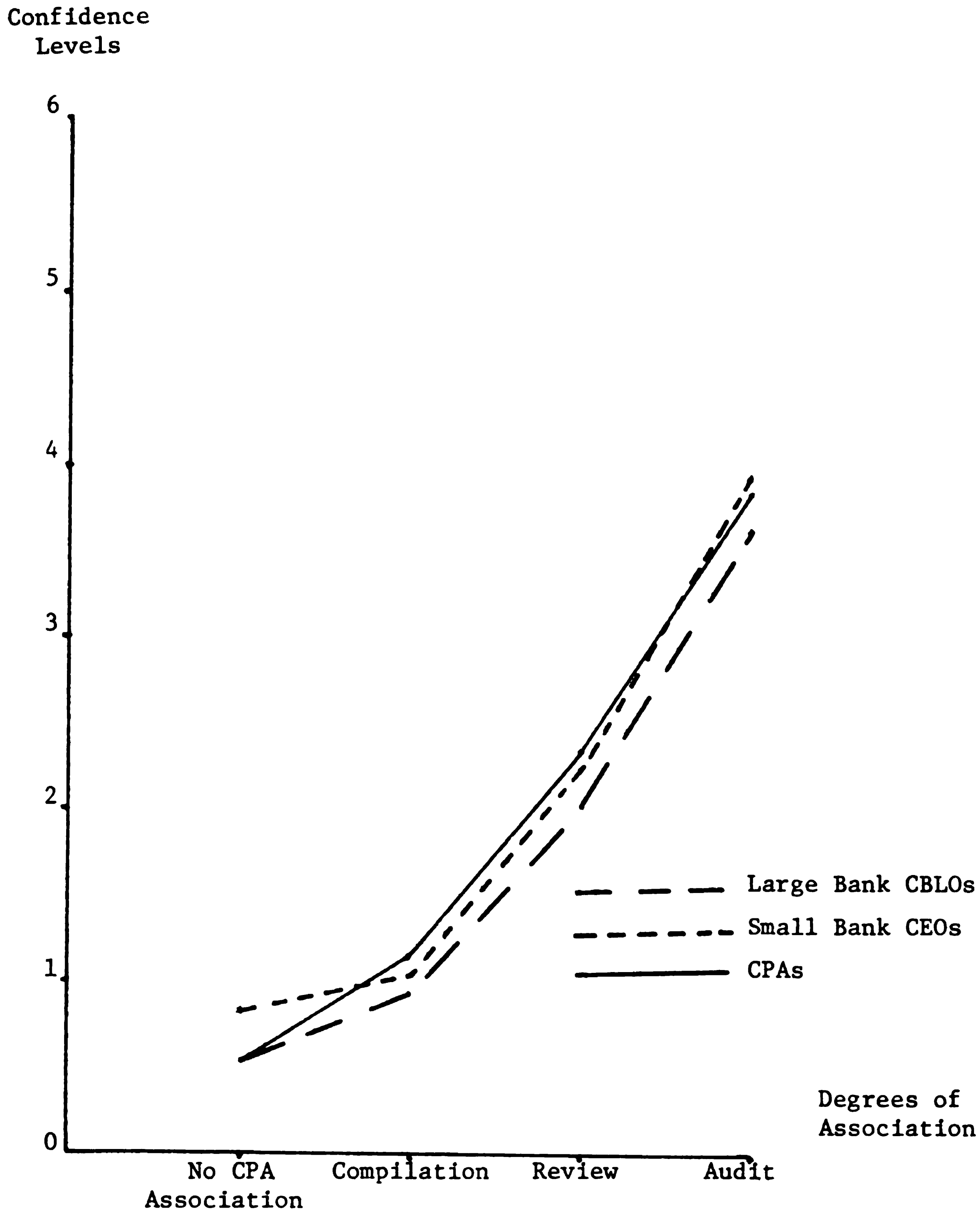


Fig. 6-5. Graph of mean scores for group effects: employee fraud.


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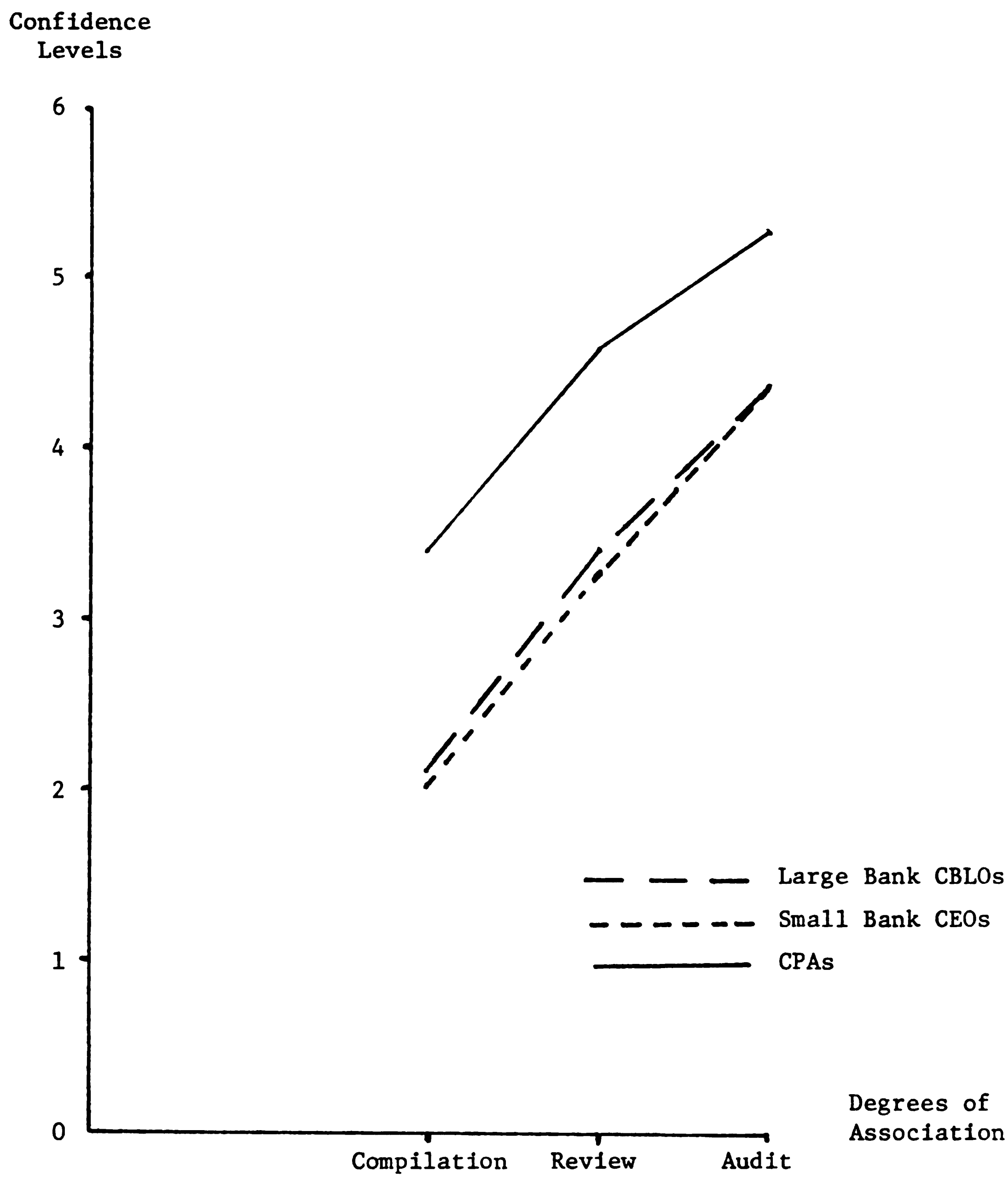


Fig. 6-6. Graph of mean scores for group effects: independence.

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Two repeated measures F-tests, which reflected the two-by-four statistical design (see Figure 5-1) were used first to test research hypotheses $H_{N1}$ through $H_{N5}$, $H_{C1}$ through $H_{C5}$, $H_{R1}$ through $H_{R5}$, and $H_{A1}$ through $H_{A5}$. Table 6-4 illustrates the F-test results for the comparisons of CPAs to large bank CBLOs. Table 6-5 illustrates the F-test results for the comparisons of CPAs to small bank CEOs. The tables show that, for both tests, the null hypothesis (that there is no group-by-degree of association interaction) was rejected at the .01 level of significance. Figures 6-1 through 6-5 support this conclusion because each graph illustrates the presence of disordinal interaction between group and degree of association factors. A consequence of rejecting this null hypothesis was that the multivariate repeated measures F-tests could not be used to test the research hypotheses. Forty univariate t-tests were then used to test these hypotheses. These t-tests compared the mean scores of CPAs with those of large bank CBLOs and of CPAs with those of small bank CEOs for each of five reliability surrogates and for each of four degrees of association. Tables 6-2 and 6-3 show the computed t-values and two-tail probabilities, and the resulting acceptance or rejection of the hypotheses.

For the condition of no CPA association with the financial statements, the results of the t-tests, illustrated by Tables 6-2 and 6-3, indicated that responding CPAs and bankers shared similar views about the financial statements for five reliability surrogates (GAAP, disclosures, unintentional error, management fraud, and employee fraud). Thus, hypotheses $H_{N1}$ through $H_{N5}$ were accepted.

For financial statements accompanied by the CPA's compilation report, Tables 6-2 and 6-3 illustrate that the t-test results were

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TABLE 6-4

RESULTS OF MULTIVARIATE REPEATED MEASURES F-TESTS ON FIVE DEPENDENT VARIABLES: LARGE BANK CBLO AND CPA COMPARISONS

| Sources of Variation | F-Value | P Value Significance |
|---|---|---|
| Group | 3.55 | .0043* |
| Degree of Association | 529.95 | .0001* |
| Group-by-Degree of Association | 7.1249 | .0001* |

*Null hypothesis rejected at a significance level of .01 or less

TABLE 6-5

RESULTS OF MULTIVARIATE REPEATED MEASURES F-TESTS ON FIVE DEPENDENT VARIABLES: SMALL BANK CEO AND CPA COMPARISONS

| Sources of Variation | F-Value | P Value Significance |
|---|---|---|
| Group | 2.41 | .0394 |
| Degree of Association | 373.10 | .0001* |
| Group-by-Degree of Association | 3.72 | .0001* |

*Null hypothesis rejected at a significance level of .01 or less

mixed. With respect to two reliability surrogates (GAAP and disclosures), responding CPAs had higher levels of confidence in the financial statements than bankers. Consequently, hypotheses $H_{C1}$ and $H_{C2}$ were rejected. With respect to three reliability surrogates (unintentional error, management fraud, and employee fraud), responding CPAs and bankers placed a similar amount of confidence in the financial statements. As a result, hypotheses $H_{C3}$, $H_{C4}$, and $H_{C5}$ were accepted.

For financial statements accompanied by the CPA's review report, Tables 6-2 and 6-3 show that the results of the t-tests again were mixed. With respect to three reliability surrogates (GAAP, disclosures, and unintentional error), responding CPAs had higher levels of confidence in the financial statements than bankers. Thus, hypotheses $H_{R1}$, $H_{R2}$, and $H_{R3}$ were rejected. With respect to two reliability surrogates (management fraud and employee fraud), responding CPAs and bankers shared similar views about the reliability of the financial statements. Therefore, hypotheses $H_{R4}$ and $H_{R5}$ were accepted.

Finally, for financial statements accompanied by the CPA's audit report, Tables 6-2 and 6-3 illustrate that the t-test results were mixed again. With respect to two reliability surrogates (disclosures and unintentional error), responding CPAs had higher levels of confidence in the financial statements than bankers. So, hypotheses $H_{A2}$ and $H_{A3}$ were rejected. With respect to two reliability surrogates (management fraud and employee fraud), responding CPAs and bankers shared similar views about the reliability of the financial statements. As a result, hypotheses $H_{A4}$ and $H_{A5}$ were accepted. With respect to the reliability surrogate, GAAP, responding CPAs had higher levels of confidence in the financial statements than large bank CBLOs. Based on this comparison, hypothesis $H_{A1}$ was rejected. However, regarding the same reliability surrogate, responding CPAs had views similar to those of small bank CEOs about the reliability of the financial statements. Based on this comparison, hypothesis $H_{A1}$ was accepted.

Next, two repeated measures F-tests, which reflected the two-by-three statistical design (see Figure 5-2) tested research hypotheses $H_{C6}$, $H_{R6}$, and $H_{A6}$. Table 6-6 illustrates the F-test results for the comparisons of CPAs to large bank CBLOs. Table 6-7 illustrates the F-test results for the comparisons of CPAs to small bank CEOs. The tables show that, for both tests, the null hypothesis (that there is no group-by-degree of association interaction) cannot be rejected at the .01 level of significance. Because interaction was not statistically significant, these tests were used to test the research hypotheses. The results of the F-tests, as shown in Table 6-6 and 6-7, indicated that group effects for both comparisons were significant. Figure 6-6 graphically illustrates these effects. These results indicated that responding CPAs and bankers did not share similar views about the extent to which financial statements are evaluated by a CPA who is independent of management. For compilation, review, and audit reports, CPAs perceived higher levels of reliability than bankers. Consequently, hypotheses $H_{C6}$, $H_{R6}$, and $H_{A6}$ were rejected.

Meaning of the Results

The computed mean scores, as shown in Tables 6-2 and 6-3, indicated three results. One result was that CBLOs from large banks shared consistently similar views with CEOs from small banks about the reliability of financial statements for each degree of association and

TABLE 6-6

RESULTS OF REPEATED MEASURES F-TESTS ON ONE DEPENDENT VARIABLE: LARGE BANK CBLO AND CPA COMPARISONS

| Sources of Variation | F Value | P Value Significance |
|---|---|---|
| Group | 62.77 | .0001* |
| Degree of Association | 147.32 | .0001* |
| Group-by-Degree of Association | 3.50 | .0318 |

*Null hypothesis rejected at a significance level of .01 or less

TABLE 6-7

RESULTS OF REPEATED MEASURES F-TESTS ON ONE DEPENDENT VARIABLE: SMALL BANK CEO AND CPA COMPARISONS

| Sources of Variation | F Value | P Value Significance |
|---|---|---|
| Group | 29.79 | .0001* |
| Degree of Association | 91.79 | .0001* |
| Group-by-Degree of Association | 1.85 | .1613 |

*Null hypothesis rejected at a significance level of .01 or less

reliability surrogate. A second result was that, when there was no CPA association with the financial statements, bankers consistently placed more confidence in the statements than CPAs for each reliability surrogate.[1] Finally, when CPAs compiled, reviewed, or audited financial statements, CPAs consistently placed more confidence in the statements than bankers for each reliability surrogate.[2]

The decision to accept or reject hypotheses, as shown in Tables 6-2 and 6-3, also indicated three results. First, with respect to twenty-two out of twenty-three hypotheses tested, there were no differences between the results of comparing CPAs to large bank CBLOs and the results of comparing CPAs to small bank CEOs. Second, when there was no CPA report accompanying the financial statements, the results indicated that all five hypotheses ($H_{N1}$ through $H_{N5}$) were accepted. Third, when the financial statements were accompanied by compilation, review, or audit reports, the results were nearly consistent for each reliability surrogate. For disclosures and independence, all six hypotheses ($H_{C2}$, $H_{C6}$, $H_{R2}$, $H_{R6}$, $H_{A2}$, and $H_{A6}$) were rejected. For GAAP, all three hypotheses ($H_{C1}$, $H_{R1}$, and $H_{A1}$) were rejected.[3] For unintentional error, two hypotheses ($H_{R3}$ and $H_{A3}$) were rejected and one hypothesis ($H_{C3}$) was accepted. For management fraud and employee

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[1] An exception to this result was that CPAs and large bank CBLOs shared similar views about employee fraud.

[2] Two exceptions to this result were: (1) CPAs and small bank CEOs shared similar views about management fraud in audits and (2) small bank CEOs placed more confidence in audited financial statements with respect to employee fraud.

[3] An exception to this result was that hypothesis $H_{A1}$, as regards the comparison of CPAs to small bank CEOs, was accepted.

fraud, all six hypotheses ($H_{C4}$, $H_{C5}$, $H_{R4}$, $H_{R5}$, $H_{A4}$, and $H_{A5}$) were accepted.

Possible reasons for the results of both the mean scores and tests of hypotheses are discussed next. The first result was that CBLOs from large banks and CEOs from small banks share similar views about the reliability of financial statements. This indicated that the bank size did not appear to affect the bankers' perceptions of the reliability of the statements. The second result was that, when there was no CPA association with the financial statements, bankers placed slightly more confidence in the reliability of the statements than CPAs. There are two possible explanations for this result. One reason might be that bankers, compared to CPAs, were more familiar with their loan customers, and consequently, placed more confidence in the statements. Another reason might be that CPAs, compared to bankers, were more skeptical about the reliability of the financial statements because they were not associated with the statements. As a result, CPAs placed less confidence in the statements than bankers. The final result was that CPAs placed more confidence in the reliability of financial statements than bankers when the statements were accompanied by the CPA's compilation report, review report, or audit report. There are three possible explanations for this finding. One possibility might be that bankers did not understand the extent or nature of CPA procedures performed on the financial statements for compilation, review, or audit engagements. For example, bankers might have perceived that the extent of CPA review procedures was less than that required by SSARS #1 and less than that actually performed by CPAs. A second possibility might be that philosophical differences existed between CPAs and bankers. For example, bankers might have been skeptical of any CPA assurances achieved or expressed about compiled financial statements because of the disclaimer-type language contained in the compilation report. A third possibility might be that CPAs perceived the achievement of more assurances about the reliability of the financial statements than that actually expressed in the CPA's report.

## Degree of Association Effects

Degree of association effects refer to the extent to which CPAs and bankers perceive different assurances about the reliability of financial statements accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. These effects relate to the following research questions (for corresponding research hypotheses, see Chapter V):

Research Question Number 5: Do users perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Research Question Number 6: Do CPAs perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

This section first presents the mean score results for degree of association effects in both tabular and graphic forms. The section then reports the results of multivariate and univariate statistical tests of the research hypotheses. Finally, the meaning of these results is discussed.

Results

The mean score results of degree of association effects are shown in the first two columns of Tables 6-8, 6-9, and 6-10. Table 6-8 compares CPAs' and bankers' perceptions of five reliability surrogates with respect to no CPA association and compilations. Table 6-9 compares CPAs' and bankers' perceptions of six reliability surrogates with respect to compilations and reviews. Table 6-10 compares CPAs' and bankers' perceptions of six reliability surrogates with respect to reviews and audits. Figures 6-7 through 6-12 graphically illustrate these respondent groups' mean scores for each reliability surrogate.

Four repeated measures F-tests and forty-five univariate t-tests were used to test the research hypotheses identified as: $H_{CB1}$ through $H_{CB6}$ and $H_{CP1}$ through $H_{CP6}$.

The first two repeated measures F-tests, described in the previous section, were used to test research hypotheses $H_{CB1}$ through $H_{CB5}$ and $H_{CP1}$ through $H_{CP5}$. Tables 6-4 and 6-5 illustrate the F-test results. The tables show that, for both tests, the null hypothesis (that there is no group-by-degree of association interaction) was rejected at the .01 level of significance. A consequence of rejecting the interaction null hypothesis was that the multivariate repeated measures F-tests could not be used to test the research hypotheses. Forty-five univariate t-tests were then used to test these hypotheses. These t-tests compared: no CPA association to compilations; compilations to reviews; and reviews to audits. These comparisons of mean scores were made for each of five reliability surrogates and for each of the three respondent groups. Tables 6-8, 6-9, and 6-10 show the computed t-values and two-tail probabilities, and the resulting

## TABLE 6-8

RESULTS OF DEGREE OF ASSOCIATION EFFECTS: COMPARISONS OF NO CPA ASSOCIATION TO COMPILATIONS

| Sample Groups and Reliability Surrogates | No CPA Association Mean | Compilations Mean | T-value | Two-tailed Significance Probability | Hypothesis | Decision |
|---|---|---|---|---|---|---|
| Large Bank CBLOs (n=101) | | | | | | |
| GAAP | .9 | 1.9 | 8.76 | .000* | $H_{CB1}$ | Reject |
| Disclosures | .5 | 1.0 | 6.35 | .000* | $H_{CB2}$ | Reject |
| Unintentional Error | .8 | 1.5 | 7.65 | .000* | $H_{CB3}$ | Reject |
| Management Fraud | .6 | 1.0 | 6.39 | .000* | $H_{CB4}$ | Reject |
| Employee Fraud | .5 | .9 | 6.40 | .000* | $H_{CB5}$ | Reject |
| Small Bank CEOs (n=29) | | | | | | |
| GAAP | .8 | 1.6 | 3.36 | .002 | $H_{CB1}$ | Accept |
| Disclosures | .6 | 1.0 | 2.70 | .012 | $H_{CB2}$ | Accept |
| Unintentional Error | .9 | 1.3 | 2.19 | .037 | $H_{CB3}$ | Accept |
| Management Fraud | .7 | .9 | 1.18 | .246 | $H_{CB4}$ | Accept |
| Employee Fraud | .8 | 1.0 | 1.18 | .246 | $H_{CB5}$ | Accept |
| CPAs (n=120) | | | | | | |
| GAAP | .5 | 2.6 | 15.60 | .000* | $H_{CP1}$ | Reject |
| Disclosures | .3 | 1.8 | 11.35 | .000* | $H_{CP2}$ | Reject |
| Unintentional Error | .6 | 1.8 | 11.43 | .000* | $H_{CP3}$ | Reject |
| Management Fraud | .4 | 1.2 | 8.30 | .000* | $H_{CP4}$ | Reject |
| Employee Fraud | .5 | 1.1 | 7.36 | .000* | $H_{CP5}$ | Reject |

*Null hypothesis rejected at a significance level of .001 or less

TABLE 6-9

RESULTS OF DEGREE OF ASSOCIATION EFFECTS: COMPARISONS OF COMPILATIONS TO REVIEWS

| Sample Groups and Reliability Surrogates | Compilations Mean | Reviews Mean | T-value | Two-tailed Significance Probability | Hypothesis | Decision |
|---|---|---|---|---|---|---|
| Large Bank CBLOs (n=101) | | | | | | |
| GAAP | 1.9 | 3.2 | 12.29 | .000* | $H_{CB1}$ | Reject |
| Disclosures | 1.0 | 2.4 | 12.30 | .000* | $H_{CB2}$ | Reject |
| Unintentional Error | 1.5 | 2.7 | 11.50 | .000* | $H_{CB3}$ | Reject |
| Management Fraud | 1.0 | 2.2 | 10.90 | .000* | $H_{CB4}$ | Reject |
| Employee Fraud | .9 | 2.0 | 10.11 | .000* | $H_{CB5}$ | Reject |
| Independence | 2.1 | 3.4 | -- | -- | $H_{CB6}$ | Reject** |
| Small Bank CEOs (n=29) | | | | | | |
| GAAP | 1.6 | 3.2 | 7.86 | .000* | $H_{CB1}$ | Reject |
| Disclosures | 1.0 | 2.3 | 5.27 | .000* | $H_{CB2}$ | Reject |
| Unintentional Error | 1.3 | 2.5 | 5.83 | .000* | $H_{CB3}$ | Reject |
| Management Fraud | .9 | 2.3 | 6.31 | .000* | $H_{CB4}$ | Reject |
| Employee Fraud | 1.0 | 2.2 | 6.53 | .000* | $H_{CB5}$ | Reject |
| Independence | 2.0 | 3.3 | -- | -- | $H_{CB6}$ | Reject** |
| CPAs (n=120) | | | | | | |
| GAAP | 2.6 | 4.0 | 11.11 | .000* | $H_{CP1}$ | Reject |
| Disclosures | 1.8 | 3.5 | 12.50 | .000* | $H_{CP2}$ | Reject |
| Unintentional Error | 1.8 | 3.3 | 12.72 | .000* | $H_{CP3}$ | Reject |
| Management Fraud | 1.2 | 2.4 | 11.13 | .000* | $H_{CP4}$ | Reject |
| Employee Fraud | 1.1 | 2.3 | 10.67 | .000* | $H_{CP5}$ | Reject |
| Independence | 3.4 | 4.6 | -- | -- | $H_{CP6}$ | Reject** |

*Null hypothesis rejected at a significance level of .001 or less

**Null hypothesis rejected as a result of repeated measures F-test

TABLE 6-10

RESULTS OF DEGREE OF ASSOCIATION EFFECTS: COMPARISONS OF REVIEWS TO AUDITS

| Sample Groups and Reliability Surrogates | Reviews Mean | Audits Mean | T-value | Two-tailed Significance Probability | Hypothesis | Decision |
|---|---|---|---|---|---|---|
| Large Bank CBLOs (n=101) | | | | | | |
| GAAP | 3.2 | 4.5 | 10.67 | .000* | $H_{CB1}$ | Reject |
| Disclosures | 2.4 | 4.0 | 12.81 | .000* | $H_{CB2}$ | Reject |
| Unintentional Error | 2.7 | 4.1 | 11.39 | .000* | $H_{CB3}$ | Reject |
| Management Fraud | 2.2 | 3.6 | 11.78 | .000* | $H_{CB4}$ | Reject |
| Employee Fraud | 2.0 | 3.6 | 13.79 | .000* | $H_{CB5}$ | Reject |
| Independence | 3.4 | 4.4 | -- | -- | $H_{CB6}$ | Reject** |
| Small Bank CEOs (n=29) | | | | | | |
| GAAP | 3.2 | 4.6 | 6.15 | .000* | $H_{CB1}$ | Reject |
| Disclosures | 2.3 | 3.9 | 5.76 | .000* | $H_{CB2}$ | Reject |
| Unintentional Error | 2.5 | 4.0 | 5.71 | .000* | $H_{CB3}$ | Reject |
| Management Fraud | 2.3 | 3.8 | 6.15 | .000* | $H_{CB4}$ | Reject |
| Employee Fraud | 2.2 | 3.9 | 6.66 | .000* | $H_{CB5}$ | Reject |
| Independence | 3.3 | 4.4 | -- | -- | $H_{CB6}$ | Reject** |
| CPAs (n=120) | | | | | | |
| GAAP | 4.0 | 5.2 | 12.43 | .000* | $H_{CP1}$ | Reject |
| Disclosures | 3.5 | 5.0 | 12.40 | .000* | $H_{CP2}$ | Reject |
| Unintentional Error | 3.3 | 4.8 | 14.80 | .000* | $H_{CP3}$ | Reject |
| Management Fraud | 2.4 | 3.8 | 12.51 | .000* | $H_{CP4}$ | Reject |
| Employee Fraud | 2.3 | 3.8 | 12.69 | .000* | $H_{CP5}$ | Reject |
| Independence | 4.6 | 5.3 | -- | -- | $H_{CP6}$ | Reject** |

*Null hypothesis rejected at a significance level of .001 or less

**Null hypothesis rejected as a result of repeated measures F-test

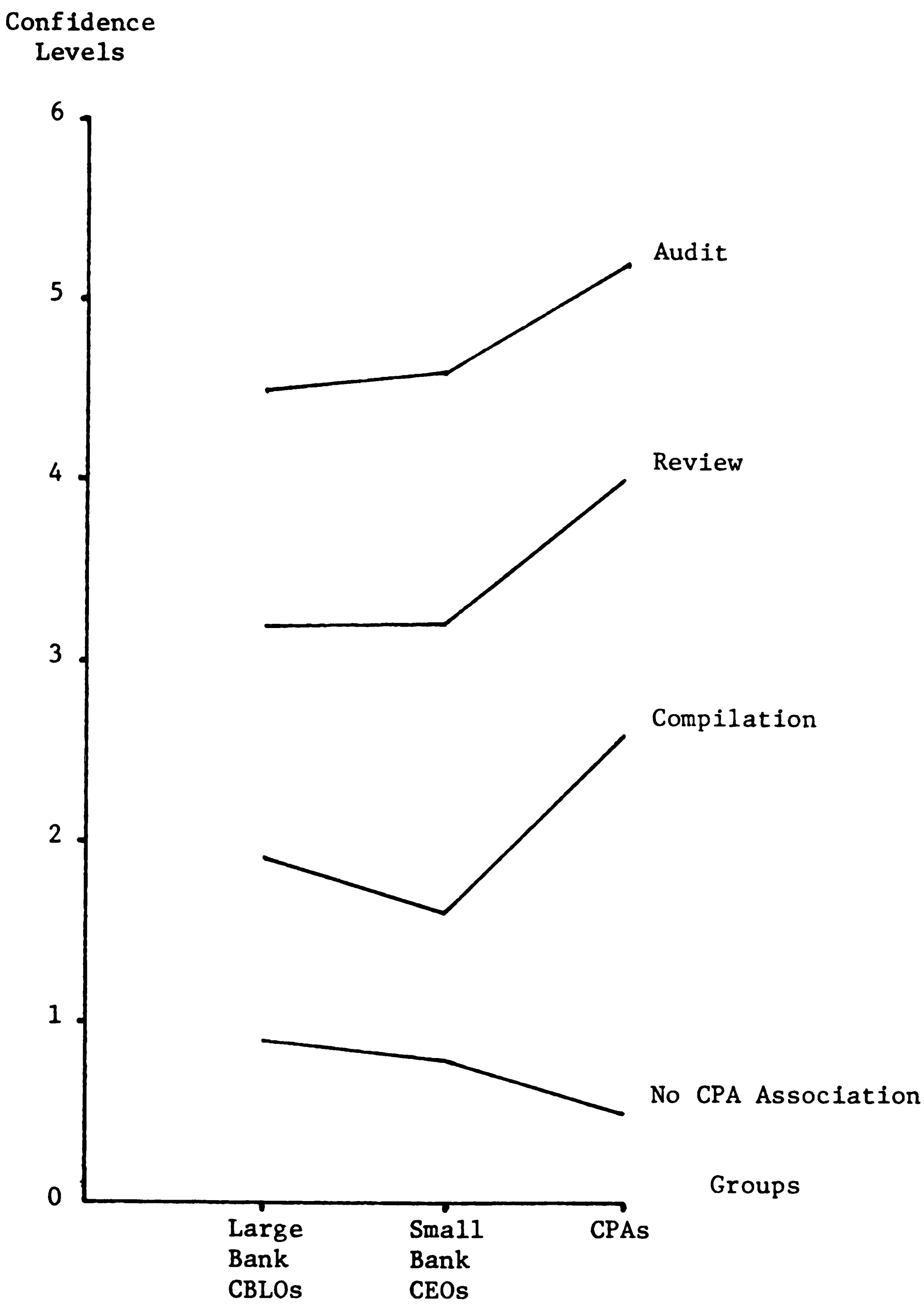


Fig. 6-7. Graph of mean scores for degree of association effects: GAAP.

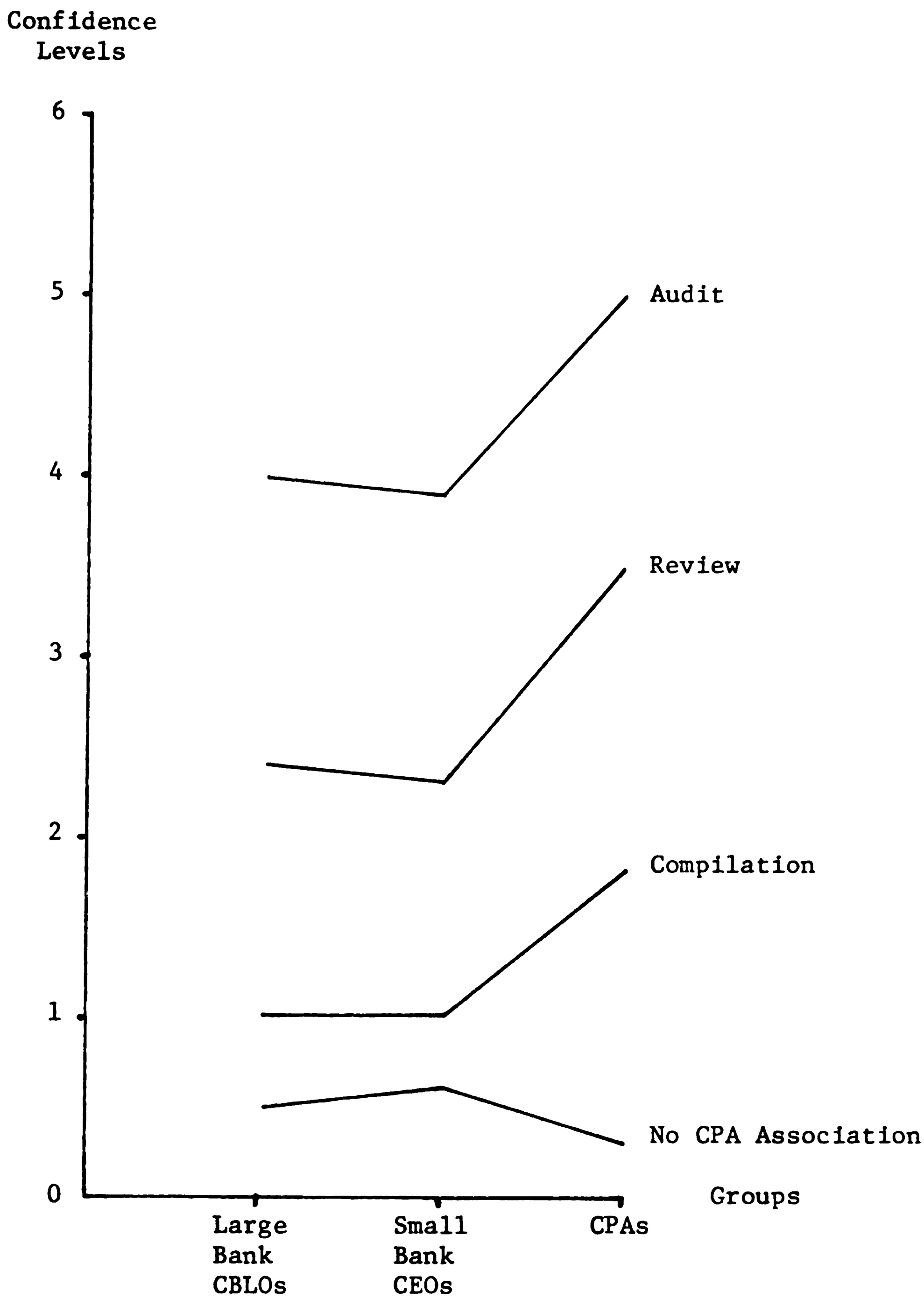


Fig. 6-8. Graph of mean scores for degree of association effects: disclosures.

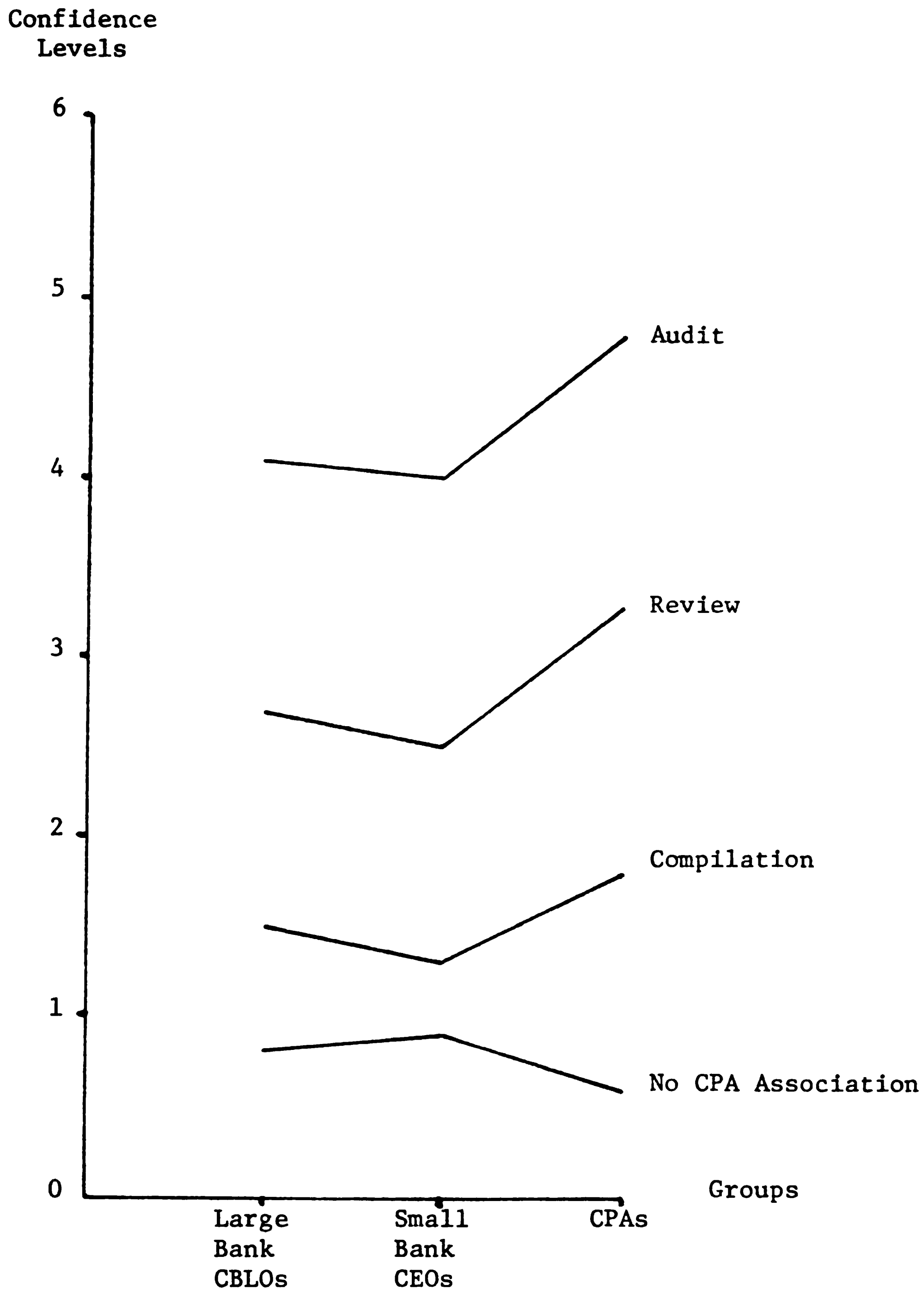


Fig. 6-9. Graph of mean scores for degree of association effects: unintentional error.

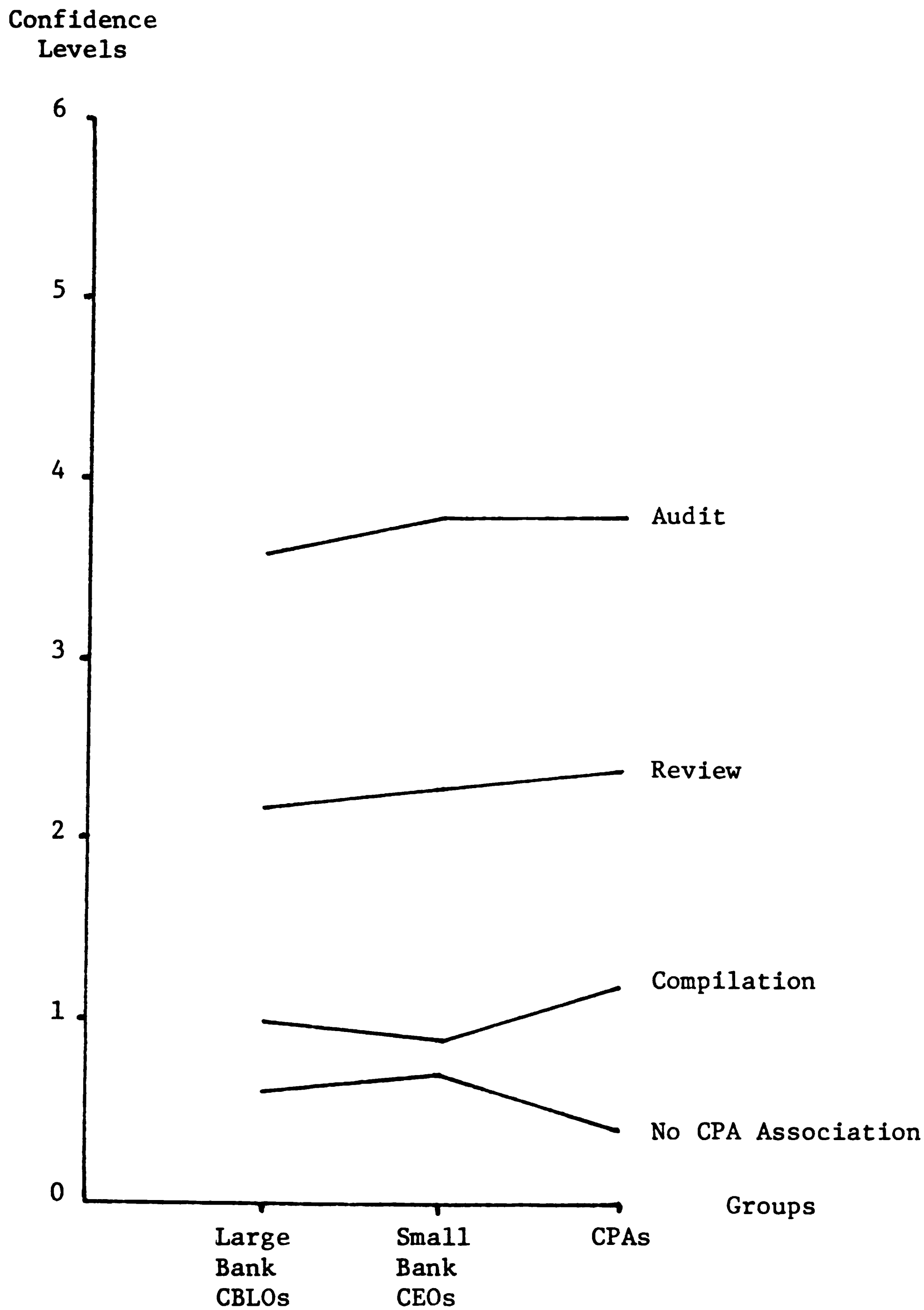


Fig. 6-10. Graph of mean scores for degree of association effects: management fraud.

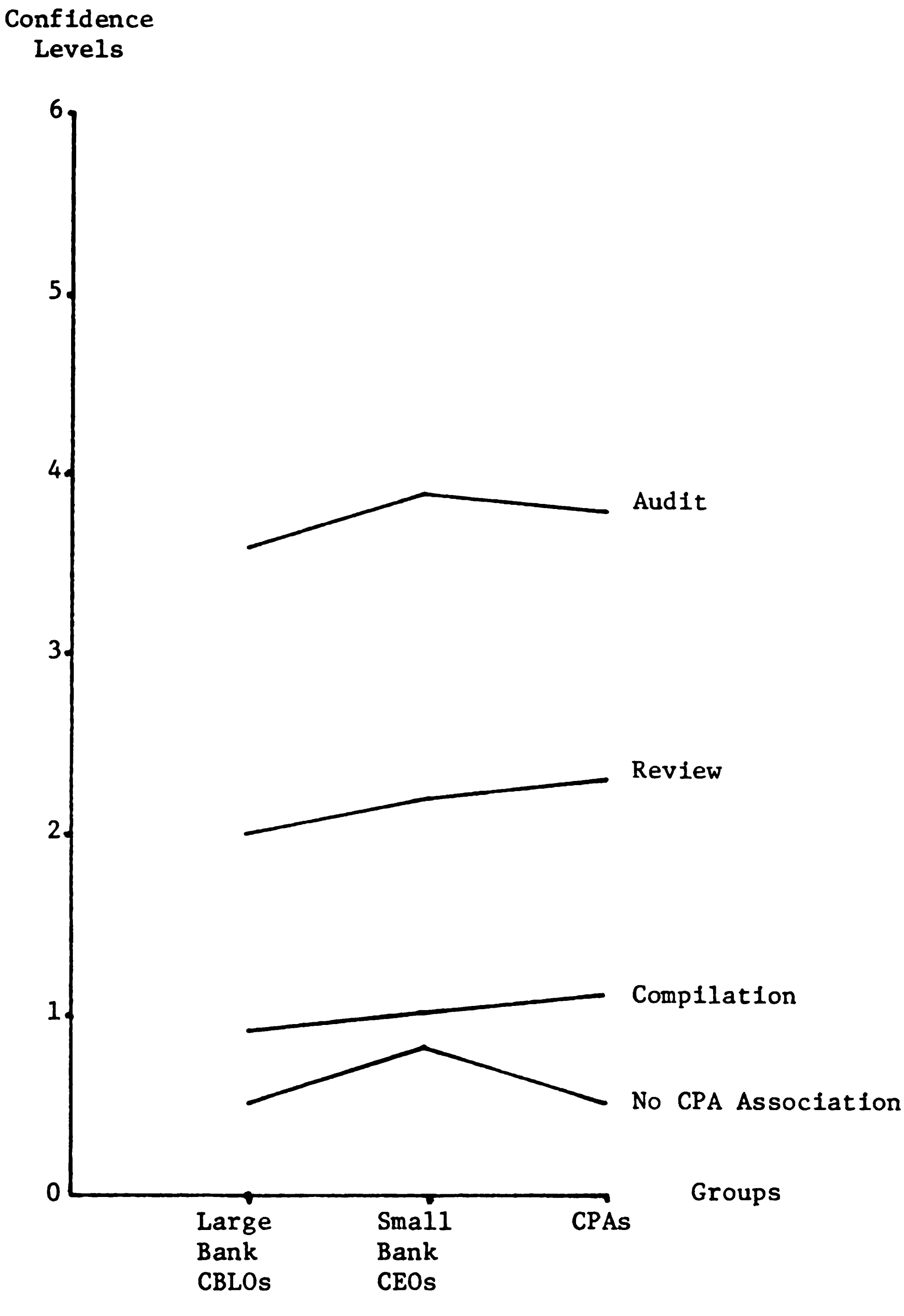


Fig. 6-11. Graph of mean scores for degree of association effects: employee fraud.

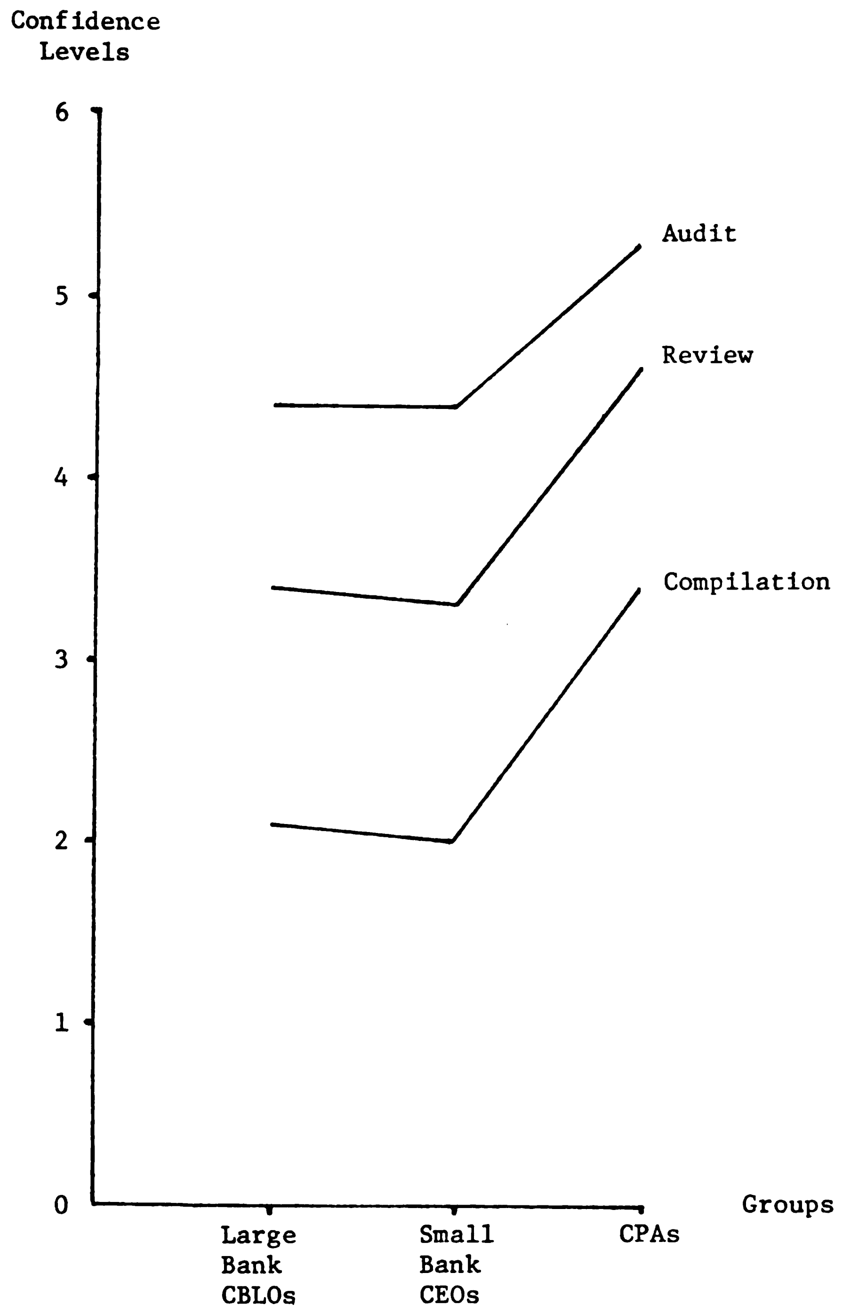


Fig. 6-12. Graph of mean scores for degree of association effects: independence.

acceptance or rejection of the hypotheses.

The results of the t-tests shown in Tables 6-8, 6-9, and 6-10 indicated that both CPAs and large bank CBLOs perceived differences among no CPA association, compilations, reviews, and audits. For each of the reliability surrogates, confidence in no CPA association was lower than confidence in compilations; confidence in compilations was lower than confidence in reviews; and confidence in reviews was lower than confidence in audits. Figures 6-7 through 6-11 graphically illustrate these differences. With respect to large bank CBLOs, hypotheses $H_{CB1}$ through $H_{CB5}$ were rejected. With respect to CPAs, hypotheses $H_{CP1}$ through $H_{CP5}$ were also rejected.

The t-test results shown in Tables 6-8, 6-9, and 6-10 were mixed regarding the responses of small bank CEOs. The tests first indicated that CEOs did not perceive differences in the reliability of financial statements prepared with no CPA association and those accompanied by compilation reports. With respect to these comparisons, hypotheses $H_{CB1}$ through $H_{CB5}$ were accepted. However, CEOs perceived differences in reliability among compilations, reviews, and audits. For each of the reliability surrogates, confidence in compilations was lower than confidence in reviews, and confidence in reviews was lower than confidence in audits. With respect to these comparisons, hypotheses $H_{CB1}$ through $H_{CB5}$ were rejected.

Next, the second two repeated measures F-tests, described in the previous section, tested research hypotheses $H_{CB6}$ and $H_{CP6}$. Tables 6-6 and 6-7 illustrate the F-test results. The tables show that, for both tests, the null hypothesis (that there is no group-by-degree of association interaction) cannot be rejected at the .01 level of significance. Because interaction was not statistically significant, these tests were used to test the research hypotheses. The results of the F-tests shown in Tables 6-6 and 6-7 indicated that degree of association effects for all comparisons were significant. Figure 6-12 graphically illustrates these effects. The results indicated that CPAs and bankers perceived different assurances about the extent of independence among CPAs who perform compilations, reviews, and audits. For this reliability surrogate, confidence in compilations was lower than confidence in reviews, and confidence in reviews was lower than confidence in audits. With respect to these comparisons, hypotheses $H_{CB6}$ and $H_{CP6}$ were rejected.

## Meaning of the Results

The computed mean scores, as shown in Tables 6-8, 6-9, and 6-10, indicated that CPAs and bankers consistently attributed increasing reliability to financial statements as the degree of CPA association with the statements progressed from no association to compilation to review to audit. The decisions to accept or reject hypotheses, as shown in Tables 6-8, 6-9, and 6-10, indicated a similar result. First, with respect to all six hypotheses tested ($H_{CB1}$ through $H_{CB6}$), the increases in bankers' confidence levels were statistically significant as the degree of CPA association progressed from no association to compilation to review to audit.[4] Second, with respect to all six hypotheses tested ($H_{CP1}$ through $H_{CP6}$), the increases in CPAs'

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[4]An exception to this result was that small bank CEOs perceived no differences between no CPA association and compilation with respect to five reliability surrogates.

confidence levels were also statistically significant as the degree of CPA association progressed from no association to compilation to review to audit. Because CPAs and bankers were able to perceive different assurances among the reports, the communication process between CPAs and financial statement users appears to be effective.

The next result, illustrated in Figures 6-7 through 6-11, pertained to bankers' confidence in financial statements accompanied by the CPA's compilation report. As shown in these graphs, the confidence bankers placed in compilations was more like the confidence placed in statements with no CPA association than the confidence placed in reviews. Since SSARS #1 requires CPAs to express no assurances about the financial statements in a compilation report, users apparently perceived accurately the intent of the CPA's compilation report.

A third result concerned CPAs' confidence in financial statements accompanied by the CPA's compilation report. As shown in Figures 6-7 through 6-11, CPAs expressed confidence about the reliability of compiled financial statements in a range from very weak confidence to medium confidence. This finding suggests two possible explanations. One possibility might be that CPAs perceived the achievement of some assurances about the reliability of compiled financial statements, despite the denial of assurances contained in the compilation report. Another possibility might be that CPAs did not understand compilation procedural or communication guidelines specified by SSARS #1. For example, CPAs might have believed that the CPA's responsibilities for compiled financial statements were greater than those required by SSARS #1. As another example, CPAs might have believed that the assurances contained in the CPA's compilation report were greater than those intended by SSARS #1.

A final result was related to CPAs' and bankers' responses to the reliability surrogate of independence when the financial statements were accompanied by the CPA's compilation report or review report. SSARS #1 requires the CPA to be independent in a review engagement and requires the CPA to be independent in a compilation engagement unless specifically disclaimed in the compilation report. Since the hypothetical compilation report contained in the questionnaire did not disclaim the CPA's independence, it was expected that the respondents would place equally high confidence in the CPA's independence for compilations, reviews, and audits. However, the results graphically shown in Figure 6-12 indicated that CPAs and bankers attributed increasing independence to the CPA as the degree of association progressed from compilation to review to audit. There are two possible explanations for this finding. One possibility might be that CPAs and users might have perceived the CPA's independence as a function of the degree of association. A second possibility might be that CPAs and bankers did not understand SSARS #1 requirements with respect to independence. A further analysis of respondents' ratings of confidence in the CPA's independence, illustrated by Table 6-11, revealed a diversity of responses. CPAs and bankers may have been confused about independence requirements contained in SSARS #1.

## Reliability Surrogate Effects

A secondary objective of the present research was to investigate reliability surrogate effects. These effects refer to the respondents' relative evaluations of the reliability surrogates for each degree

# TABLE 6-11

RATINGS OF INDEPENDENCE WHEN THE FINANCIAL STATEMENTS
ARE ACCOMPANIED BY THE CPA's COMPILATION REPORT

| Rating Scale Category | Large Bank CBLOs | | Small Bank CEOs | | CPAs | |
|---|---|---|---|---|---|---|
| | Number of Responses | Percentage of Responses | Number of Responses | Percentage of Responses | Number of Responses | Percentage of Responses |
| No Confidence | 23 | 22.8% | 5 | 17.3% | 13 | 10.8% |
| Very Weak Confidence | 22 | 21.8 | 9 | 31.0 | 8 | 6.6 |
| Weak Confidence | 17* | 16.8 | 5 | 17.3 | 15 | 12.5 |
| Medium Confidence | 17 | 16.8 | 3 | 10.3 | 24 | 20.0 |
| Strong Confidence | 12 | 11.9 | 4 | 13.8 | 23 | 19.2 |
| Very Strong Confidence | 4 | 4.0 | 3 | 10.3 | 14 | 11.7 |
| Complete Confidence | 6 | 5.9 | - | -- | 23 | 19.2 |
| Total | 101 | 100.0% | 29 | 100.0% | 120 | 100.0% |

*Includes one response which was between Very Weak and Weak of association. This section first presents the mean score results for reliability surrogate effects in graphic form. Then, the results of univariate statistical tests of mean score pair comparisons are reported. Finally, the meaning of these results is discussed.

Results

The mean score results of reliability surrogate effects for each degree of association are graphically illustrated by Figures 6-13 through 6-16. Each graph plots the mean scores of the reliability surrogates for each responding group and for a particular degree of association. One hundred and sixty-five univariate t-tests were then used to test the differences in mean scores for all possible reliability surrogate pair comparisons. These t-tests were performed for each sample group and for each degree of association. Tables 6-12 through 6-15 show the computed t-values and two-tail probabilities for the pair comparisons. Table 6-1 lists the mean scores of the reliability surrogates plotted on the graphs and used in the t-test pair comparisons.

Figure 6-13 and Table 6-12 present the results of reliability surrogate effects when there was no CPA association with the financial statements. These results are described below:

1. Large bank CBLOs placed more confidence in two reliability surrogates (GAAP and unintentional error) than in the other three reliability surrogates (disclosures, management fraud, and employee fraud).

2. Small bank CEOs placed equal levels of confidence in all the reliability surrogates.

3. CPAs placed more confidence in two reliability surrogates

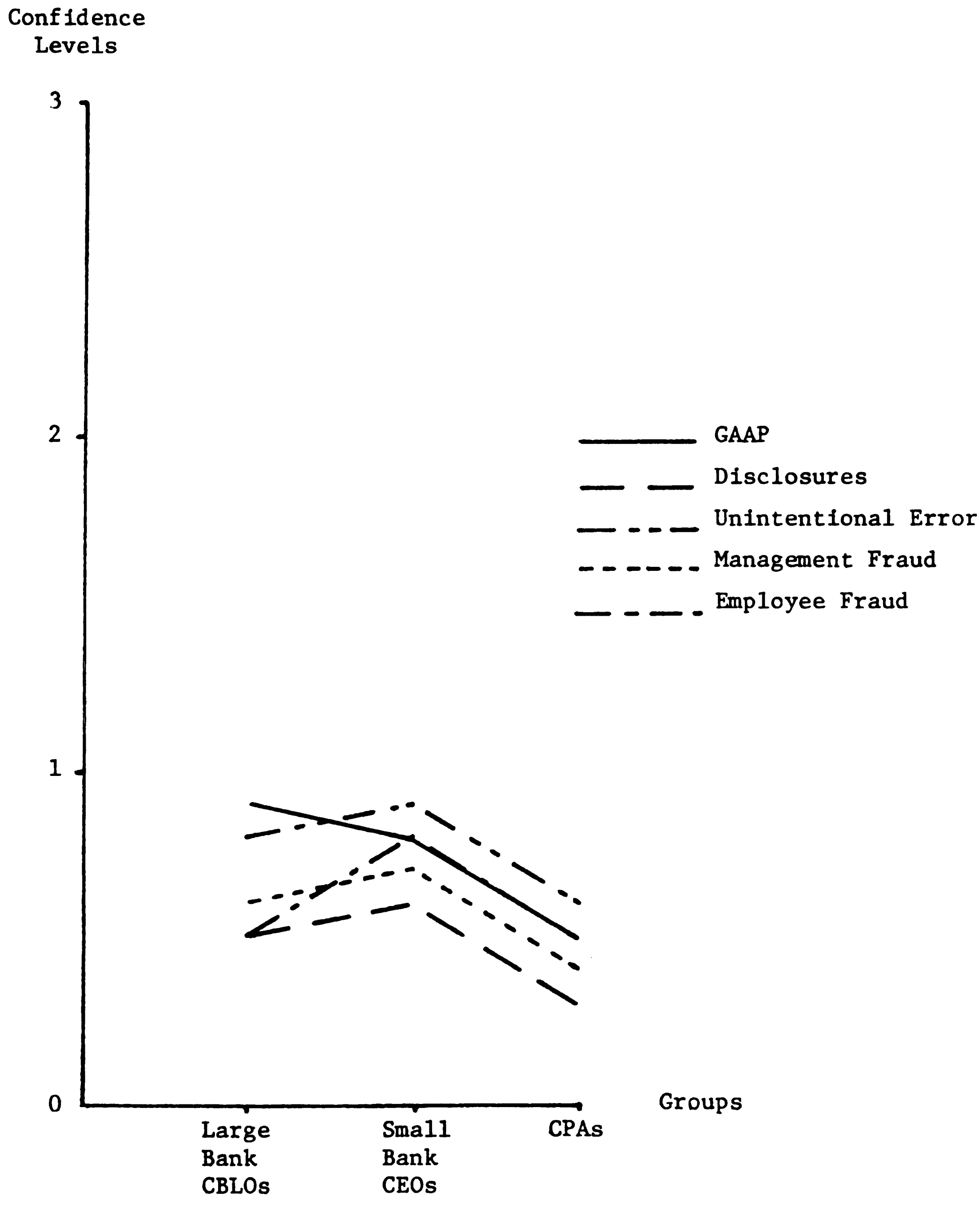


Fig. 6-13. Graph of mean scores for reliability surrogate effects: no CPA association.

# TABLE 6-12

RESULTS OF RELIABILITY SURROGATE EFFECTS: PAIR COMPARISONS OF RELIABILITY SURROGATES FOR NO CPA ASSOCIATION

| Reliability Surrogate Pair Comparisons | Large Bank CBLOs (n=101) | | Small Bank CEOs (n=29) | | CPAs (n=120) | |
|---|---|---|---|---|---|---|
| | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability |
| GAAP - Disclosures | 6.01 | .000* | 1.89 | .070 | 4.18 | .000* |
| GAAP - Unintentional Error | 1.22 | .225 | - .33 | .745 | - .31 | .759 |
| GAAP - Management Fraud | 4.94 | .000* | 1.44 | .161 | 2.18 | .032 |
| GAAP - Employee Fraud | 4.98 | .000* | 1.00 | .326 | 1.73 | .086 |
| GAAP - Independence | -- | -- | -- | -- | -- | -- |
| Disclosures - Unintentional Error | 5.11 | .000* | 2.12 | .043 | 3.74 | .000* |
| Disclosures - Management Fraud | 1.79 | .077 | .90 | .375 | 2.07 | .041 |
| Disclosures - Employee Fraud | - .93 | .356 | -1.98 | .057 | -2.52 | .013 |
| Disclosures - Independence | -- | -- | -- | -- | -- | -- |
| Unintentional Error - Management Fraud | 4.24 | .000* | 1.41 | .169 | 2.48 | .015 |
| Unintentional Error - Employee Fraud | 4.38 | .000* | .90 | .375 | 1.92 | .057 |
| Unintentional Error - Independence | -- | -- | -- | -- | -- | -- |
| Management Fraud - Employee Fraud | 1.30 | .198 | -1.00 | .326 | -1.15 | .253 |
| Management Fraud - Independence | -- | -- | -- | -- | -- | -- |
| Employee Fraud - Independence | -- | -- | -- | -- | -- | -- |

*Significant at .001 or less

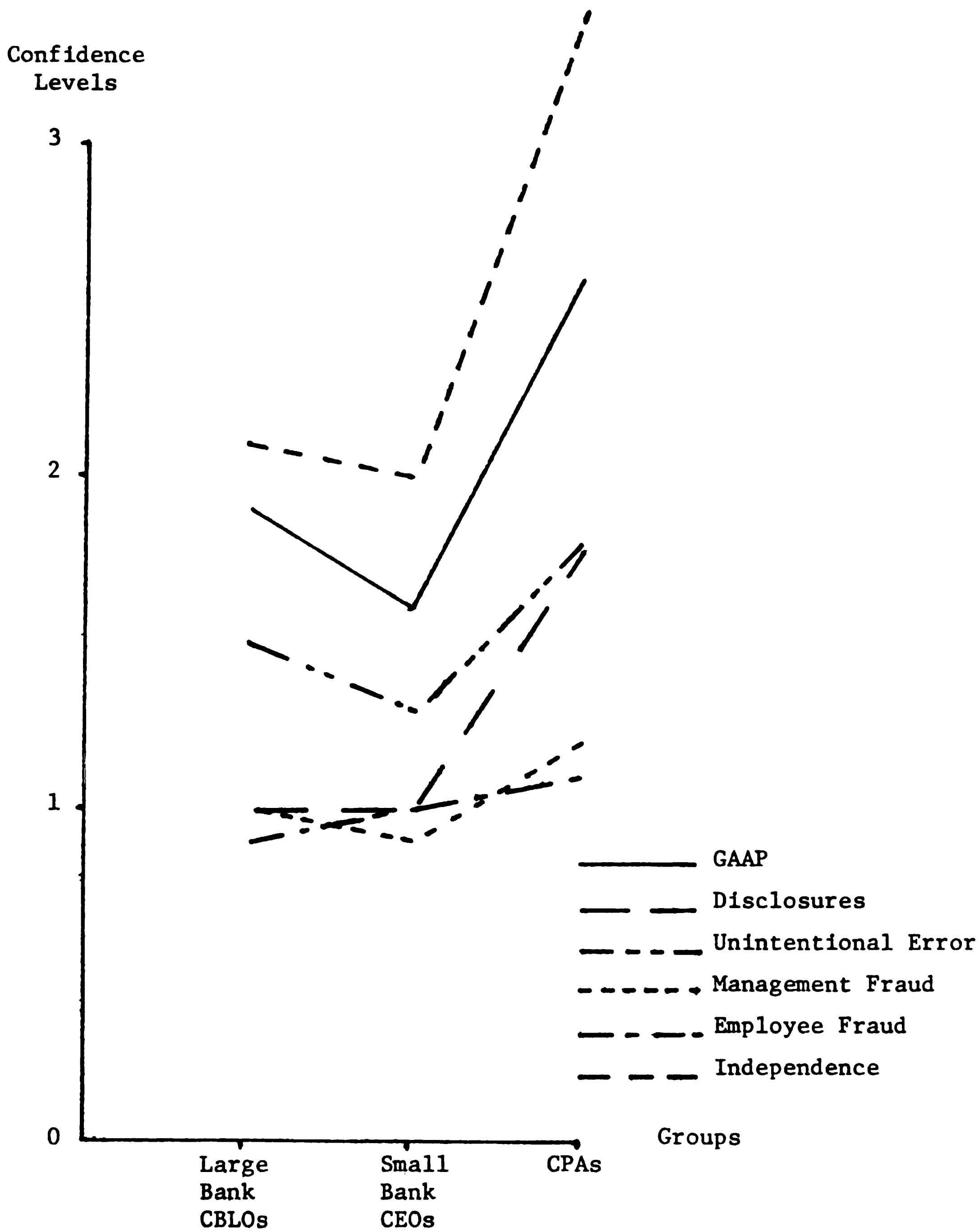


Fig. 6-14. Graph of mean scores for reliability surrogate effects: compilations.

# TABLE 6-13

RESULTS OF RELIABILITY SURROGATE EFFECTS: PAIR COMPARISONS OF RELIABILITY SURROGATES FOR COMPILATIONS

| Reliability Surrogate Pair Comparisons | Large Bank CBLOs (n=101) | | Small Bank CEOs (n=29) | | CPAs (n=120) | |
|---|---|---|---|---|---|---|
| | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability |
| GAAP - Disclosures | 8.01 | .000* | 2.91 | .007 | 7.41 | .000* |
| GAAP - Unintentional Error | 4.37 | .000* | 2.07 | .048 | 7.28 | .000* |
| GAAP - Management Fraud | 8.24 | .000* | 3.58 | .001* | 10.93 | .000* |
| GAAP - Employee Fraud | 8.94 | .000* | 2.84 | .008 | 11.78 | .000* |
| GAAP - Independence | -1.35 | .179 | -2.04 | .051 | -4.35 | .000* |
| Disclosures - Unintentional Error | 4.85 | .000* | 1.68 | .103 | .15 | .882 |
| Disclosures - Management Fraud | .07 | .945 | - .90 | .375 | -4.92 | .000* |
| Disclosures - Employee Fraud | 1.34 | .183 | .30 | .769 | 5.81 | .000* |
| Disclosures - Independence | 6.66 | .000* | 3.50 | .002 | 9.20 | .000* |
| Unintentional Error - Management Fraud | 5.81 | .000* | 2.37 | .025 | 6.77 | .000* |
| Unintentional Error - Employee Fraud | 6.19 | .000* | 1.80 | .083 | 7.80 | .000* |
| Unintentional Error - Independence | -3.89 | .000* | -3.02 | .005 | -8.38 | .000* |
| Management Fraud - Employee Fraud | 2.39 | .019 | -1.00 | .326 | 2.03 | .045 |
| Management Fraud - Independence | 6.66 | .000* | 4.01 | .000* | 11.28 | .000* |
| Employee Fraud - Independence | 7.18 | .000* | 3.75 | .001* | 12.42 | .000* |

*Significant at .001 or less

(GAAP and unintentional error) than in the surrogate, disclosures.

Figure 6-14 and Table 6-13 present the results of reliability surrogate effects when the financial statements are accompanied by the CPA's compilation report. These results are described below:

1. Both CPAs and large bank CBLOs placed more confidence in two reliability surrogates (GAAP and independence) than in the other four surrogates (disclosures, unintentional error, management fraud, and employee fraud).

2. Small bank CEOs placed more confidence in two reliability surrogates (GAAP and independence) than in the surrogate, management fraud.

3. Small bank CEOs placed more confidence in the reliability surrogate of independence, than in the surrogate of employee fraud.

4. Large bank CBLOs placed more confidence in the reliability surrogate of unintentional error, than in the three surrogates of disclosures, management fraud, and employee fraud.

5. CPAs placed more confidence in two reliability surrogates (disclosures and unintentional error) than two other surrogates (management fraud and employee fraud).

Figure 6-15 and Table 6-14 present the results of reliability surrogate effects when the financial statements are accompanied by the CPA's review report. These results are described below:

1. CPAs, large bank CBLOs, and small bank CEOs placed more confidence in two reliability surrogates (GAAP and independence) than the other four surrogates (disclosures, unintentional error, management fraud, and employee fraud).

2. Large bank CBLOs placed more confidence in the reliability

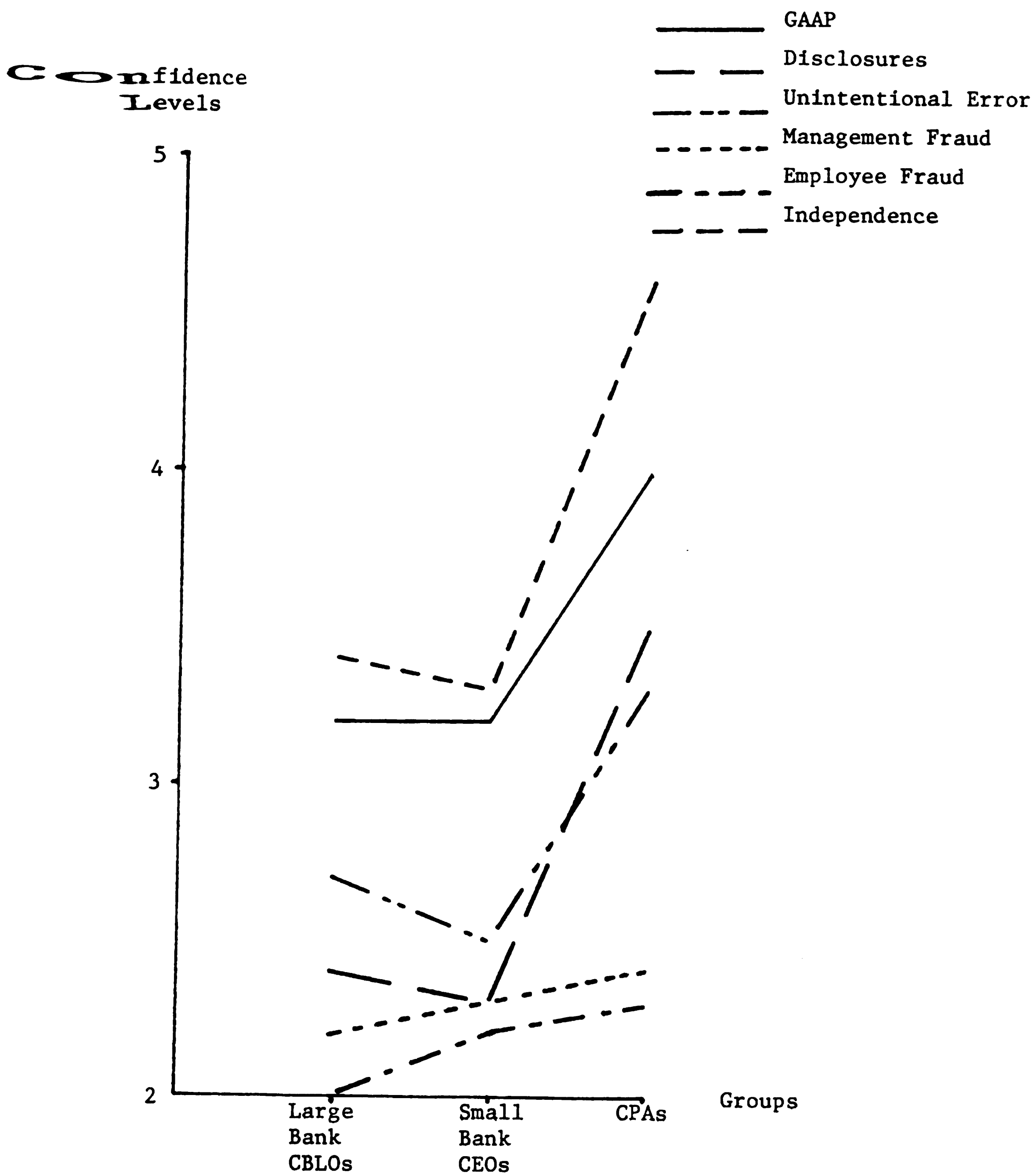


Fig. 6-15. Graph of mean scores for reliability surrogate effects: reviews.

# TABLE 6-14

RESULTS OF RELIABILITY SURROGATE EFFECTS: PAIR COMPARISONS OF RELIABILITY SURROGATES FOR REVIEWS

| Reliability Surrogate Pair Comparisons | Large Bank CBLOs (n=101) | | Small Bank CEOs (n=29) | | CPAs (n=120) | |
|---|---|---|---|---|---|---|
| | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability |
| GAAP - Disclosures | 8.01 | .000* | 5.07 | .000* | 6.51 | .000* |
| GAAP - Unintentional Error | 6.14 | .000* | 4.37 | .000* | 7.04 | .000* |
| GAAP - Management Fraud | 9.85 | .000* | 4.61 | .000* | 13.01 | .000* |
| GAAP - Employee Fraud | 12.46 | .000* | 5.51 | .000* | 13.80 | .000* |
| GAAP - Independence | -1.25 | .214 | - .78 | .445 | -6.01 | .000* |
| Disclosures - Unintentional Error | 3.42 | .001* | .82 | .421 | -1.66 | .099 |
| Disclosures - Management Fraud | -2.34 | .021 | - .20 | .846 | -9.23 | .000* |
| Disclosures - Employee Fraud | 5.83 | .000* | .72 | .477 | 10.40 | .000* |
| Disclosures - Independence | 7.84 | .000* | 4.99 | .000* | 9.98 | .000* |
| Unintentional Error - Management Fraud | 6.07 | .000* | .92 | .364 | 8.33 | .000* |
| Unintentional Error - Employee Fraud | 8.63 | .000* | 1.39 | .174 | 8.96 | .000* |
| Unintentional Error - Independence | -5.22 | .000* | -3.64 | .001* | -10.78 | .000* |
| Management Fraud - Employee Fraud | 4.95 | .000* | .63 | .537 | 1.89 | .061 |
| Management Fraud - Independence | 10.18 | .000* | 3.94 | .000* | 14.97 | .000* |
| Employee Fraud - Independence | 11.47 | .000* | 4.92 | .000* | 15.93 | .000* |

*Significant at .001 or less

surrogate, unintentional error, than in three other surrogates (disclosures, management fraud, and employee fraud).

3. Large bank CBLOs placed more confidence in the two reliability surrogates of disclosures and management fraud than in the surrogate of employee fraud.

4. CPAs placed more confidence in the two reliability surrogates of disclosures and unintentional error than in the two surrogates of management fraud and employee fraud.

5. CPAs placed more confidence in the reliability surrogate of independence than in the surrogate of GAAP.

Figure 6-16 and Table 6-15 present the results of reliability surrogate effects when the financial statements are accompanied by the CPA's audit report. These results are described below:

1. Both CPAs and large bank CBLOs placed more confidence in the two reliability surrogates of GAAP and independence than in the other four surrogates (disclosures, unintentional error, management fraud, and employee fraud).

2. Both CPAs and large bank CBLOs placed more confidence in two reliability surrogates (disclosures and unintentional error) than in two other surrogates (management fraud and employee fraud).

3. Small bank CEOs placed more confidence in the reliability surrogate, GAAP, than in the four surrogates of disclosures, unintentional error, management fraud, and employee fraud.

4. Small bank CEOs placed more confidence in the reliability surrogate of independence than in the surrogate of employee fraud.

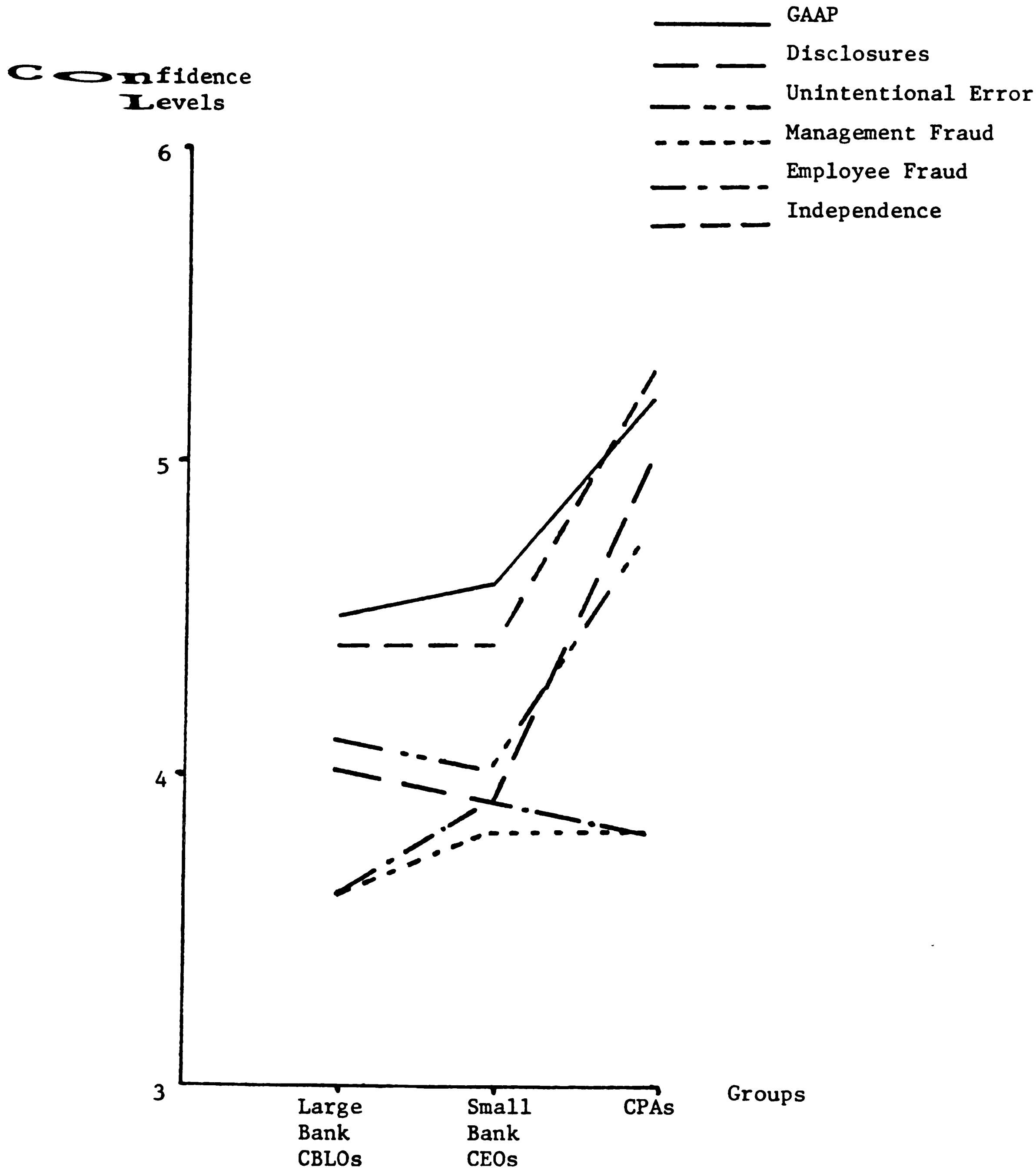


Fig. 6-16. Graph of mean scores for reliability surrogate effects; audits.

# TABLE 6-15

RESULTS OF RELIABILITY SURROGATE EFFECTS: PAIR COMPARISONS OF RELIABILITY SURROGATES FOR AUDITS

| Reliability Surrogate Pair Comparisons | Large Bank CBLOs (n=101) | | Small Bank CEOs (n=29) | | CPAs (n=120) | |
|---|---|---|---|---|---|---|
| | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability | T-value | Two-tailed Significance Probability |
| GAAP - Disclosures | 6.21 | .000* | 4.13 | .000* | 3.93 | .000* |
| GAAP - Unintentional Error | 5.20 | .000* | 3.73 | .001* | 5.29 | .000* |
| GAAP - Management Fraud | 10.15 | .000* | 4.05 | .000* | 12.58 | .000* |
| GAAP - Employee Fraud | 9.62 | .000* | 4.33 | .000* | 12.38 | .000* |
| GAAP - Independence | .74 | .459 | 1.00 | .326 | -1.70 | .092 |
| Disclosures - Unintentional Error | 1.00 | .320 | .70 | .488 | -1.72 | .088 |
| Disclosures - Management Fraud | -4.92 | .000* | - .30 | .763 | -10.08 | .000* |
| Disclosures - Employee Fraud | 4.73 | .000* | - .02 | .983 | 10.24 | .000* |
| Disclosures - Independence | 4.26 | .000* | 3.43 | .002 | 6.22 | .000* |
| Unintentional Error - Management Fraud | 5.57 | .000* | 1.02 | .318 | 9.55 | .000* |
| Unintentional Error - Employee Fraud | 5.27 | .000* | .68 | .502 | 9.33 | .000* |
| Unintentional Error - Independence | -3.48 | .001* | -3.22 | .003 | -6.34 | .000* |
| Management Fraud - Employee Fraud | - .08 | .934 | - .52 | .610 | - .29 | .769 |
| Management Fraud - Independence | 8.61 | .000* | 3.39 | .002 | 13.65 | .000* |
| Employee Fraud - Independence | 8.21 | .000* | 3.79 | .001* | 13.50 | .000* |

*Significant at .001 or less

Meaning of the Results

One indication of the results was that when the financial statements are accompanied by compilation, review, or audit reports, CPAs and bankers consistently placed more confidence in both GAAP and independence than in each of the other reliability surrogates. There are two possible explanations for the higher confidence levels attributed to GAAP. One might be that the respondents believed that CPAs achieved and expressed more assurances about GAAP than the other reliability surrogates. Another possible explanation might be that respondents were more familiar with GAAP. This familiarity with GAAP might have been achieved by previous experience or by references to GAAP contained in the CPA's review and audit reports. An explanation for the higher confidence in independence might be that AICPA standards require a CPA to be independent in audit and review engagements. Further, the AICPA compilation and review standard requires a CPA to be independent in compilation engagements, unless specifically disclaimed in the compilation report.

A second indication of the results was that when the financial statements are accompanied by compilation, review, or audit reports, CPAs and bankers consistently placed less confidence in both management fraud and employee fraud than in each of the other reliability surrogates. There are three possible explanations for this finding. One might be that CPAs and bankers believed that CPAs were not responsible for detecting the effects of management fraud or employee fraud. Another possibility might be that CPAs and bankers believed that CPAs were not capable of detecting the effects of management fraud or employee fraud. A final possibility is that fraud might be related more to the integrity of management personnel and employees than to financial statements. In support of this last possibility, several respondents indicated in written comments on the questionnaire that their ratings of management fraud and employee fraud were lower than the other reliability surrogates. Their reason was that evaluating the integrity of a company's personnel would be more likely to uncover the effects of fraud than evaluating its financial statements.

## Familiarity Effects

Another secondary objective of the present study was to investigate the extent to which CPAs and bankers were familiar with compilations and reviews. Table 6-16 presents the percentages of responding large bank CBLOs and small bank CEOs who answered "yes" to six questions about their familiarity with compilations and reviews. Table 6-17 presents the percentages of responding CPAs who answered "yes" to six similar questions about their familiarity with compilations and reviews. This section first describes these percentages and then discusses the meaning of the results.

### Results

The results first indicated that nearly all responding large bank CBLOs (95.2%) and CPAs (95.9%) have read materials about compilations and reviews. About half of the responding small bank CEOs (51.4%) have read materials about compilations and reviews. A smaller percentage of large bank CBLOs (32.4%), small bank CEOs (2.9%), and CPAs (51.6%) reported attendance at a seminar or educational workshop on compilations and reviews sponsored by their bank or firm. However, a higher percentage of large bank CBLOs (59.0%), small bank CEOs

TABLE 6-16

FAMILIARITY EFFECTS: RESPONSES OF LARGE BANK CBLOs AND SMALL BANK CEOs TO QUESTIONS ABOUT COMPILATIONS AND REVIEWS

| Familiarity Questions | Percentage of Large Bank CBLOs Answering "Yes" | Percentage of Small Bank CEOs Answering "Yes" |
|---|---|---|
| Have you read any materials about compilations and reviews? | 95.2% | 51.4% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by your bank? | 32.4% | 2.9% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by an organization other than your bank? | 59.0% | 17.1% |
| Have you seen a CPA's compilation report accompanying the financial statements of any of your bank's customers? | 74.3% | 54.3% |
| Have you seen a CPA's review report accompanying the financial statements of any of your bank's customers? | 76.2% | 45.7% |
| Do you now use or expect to use in the future compilation reports or review reports prepared by CPAs? | 93.3% | 68.6% |

Note: The percentages in this table are sample percentages and, therefore, are subject to sample variability. The standard error of a sample percentage is approximately 50% divided by the square root of the sample size.

TABLE 6-17

FAMILIARITY EFFECTS: RESPONSES OF CPAs TO QUESTIONS ABOUT COMPILATIONS AND REVIEWS

| Familiarity Questions | Percentage of CPAs Answering "Yes" |
|---|---|
| Have you read any materials about compilations and reviews? | 95.9% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by your firm? | 51.6% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by an organization other than your firm? | 63.9% |
| Have you seen a CPA's compilation report accompanying the financial statements of any of your firm's clients? | 73.8% |
| Have you seen a CPA's review report accompanying the financial statements of any of your firm's clients? | 63.9% |
| Do you now or in the future do you expect to participate in compilation or review engagements? | 91.0% |

Note: The percentages in this table are sample percentages and, therefore, are subject to sample variability. The standard error of a sample percentage is approximately 50% divided by the square root of the sample size.

(17.1%), and CPAs (63.9%) reported attendance at a seminar or educational workshop sponsored by an organization other than their bank or firm. The results also indicated that a majority of responding large bank CBLOs (74.3%), small bank CEOs (54.3%), and CPAs (73.8%) reported seeing a compilation report in practice. A similar number of responding large bank CBLOs (76.2%), small bank CEOs (45.7%), and CPAs (63.9%) reported seeing a review report in practice. Finally, most responding large bank CBLOs (93.3%) and small bank CEOs (68.6%) used or expected to use a CPA's compilation or review report. In a related question, nearly all responding CPAs (91.0%) had participated or expected to participate in compilation or review engagements.

## Meaning of the Results

Responses to these familiarity questions first indicated that the CPAs and large bank CBLOs were more familiar with compilations and reviews than the small bank CEOs. There are two possible reasons for this finding. One reason might be that small bank CEOs relied more on their familiarity with loan customers than on CPA reports as a basis for making loan decisions. Consequently, these banks might not need to use compilation reports and review reports. Another reason might be that small banks did not have sufficient financial resources or time to justify education in the area of compilations and reviews.

The results next indicated that fewer respondents had gained familiarity with compilations and reviews by attending a seminar or educational workshop sponsored by their organization. It may be that many of the large bank CBLOs attended seminars sponsored by large CPA firms, the Michigan Association of Certified Public Accountants (MACPA), or Robert Morris Associates. Another reason might be that many of the CPAs who were sole practitioners or local firm members attended seminars sponsored by large CPA firms or the MACPA. A final reason might be that most small banks probably did not have sufficient resources to justify sponsoring a seminar or workshop.

Next, the results indicated that a high percentage of all respondents reported seeing compilation and review reports in practice, and expected to either use such reports or participate in such engagements. This finding suggested that compilations and reviews were relevant to the loan decision process involving CPAs, financial statements of nonpublic businesses, and bankers.

Finally, the results indicated that the respondents were generally familiar with compilations and reviews. A possible explanation for this result might be that the accounting and banking professions educated most of their members about compilations and reviews.

## Summary

This chapter presented the data and results of statistical tests used in the present research to assess the effectiveness of the communication process between CPAs and bankers. The chapter described the results in terms of four categories. These were group effects, degree of association effects, reliability surrogate effects, and familiarity effects. First, the results associated with group effects indicated that CPAs placed more confidence in the reliability of financial statements than bankers did when the statements were accompanied by compilation reports, review reports, or audit reports. Second, the results related to degree of association effects showed that both CPAs and bankers attributed increasing reliability to the financial statements as the degree of CPA association progressed from no association to compilation to review to audit. Third, the results pertaining to reliability surrogate effects demonstrated that both CPAs and bankers (1) placed more confidence in GAAP and independence than in each of the other reliability surrogates, and (2) placed less confidence in management fraud and employee fraud than in each of the other reliability surrogates. Finally, the results regarding familiarity effects showed that both CPAs and bankers were generally familiar with compilations and reviews.

The last chapter summarizes the results of the present study, presents conclusions, and discusses implications of these results. The chapter also describes limitations of the results and suggests topics for future research.

## CHAPTER VII

## SUMMARY OF RESULTS, CONCLUSIONS, AND IMPLICATIONS

This thesis empirically tested the effectiveness of the communication process between certified public accountants (CPAs) and bankers within the framework of financial reporting for nonpublic businesses. The aspect of the communication process investigated was the similarities with which CPAs and bankers perceive assurances about financial statements accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. The form of assurance investigated was the reliability of the financial statements. This was defined as the extent to which financial statements are (1) in conformity with generally accepted accounting principles (GAAP), (2) accompanied by all material disclosures (disclosures), (3) free from the effects of an existing material unintentional error (unintentional error), (4) free from the effects of an existing material management fraud (management fraud), (5) free from the effects of an existing material employee fraud (employee fraud), and (6) evaluated by a CPA who is independent of management (independence).

To accomplish the objectives of the present study stated in Chapter I, questionnaires were mailed to 200 randomly selected CPAs practicing in Michigan. Questionnaires were also mailed to 200 randomly selected bankers practicing in Michigan. Of these, 130 were commercial bank loan officers (CBLOs) from large banks and 70 were chief executive officers (CEOs) from small banks. Appendices A and B illustrate the questionnaires which were mailed to the CPA and banker groups. Responses from 120 CPAs, 101 large bank CBLOs, and 29 small bank CEOs comprised the results of the study. The questionnaire measured respondents' perceptions of the reliability of financial statements for six reliability surrogates and for four degrees of CPA association with financial statements. Respondents' perceptions of reliability were measured on a seven-point rating scale provided after each reliability surrogate on the questionnaire. The seven scale points and numerical values assigned to them were: no confidence, 0; very weak confidence, 1; weak confidence, 2; medium confidence, 3; strong confidence, 4; very strong confidence, 5; and complete confidence, 6. Table 7-1 summarizes the numerical mean scores of these responses for each sample group. Parametric multivariate F-tests and univariate t-tests were then used to test research hypotheses about these data.

This chapter first presents a summary of the results and conclusions based on these results. The chapter then discusses the implications of the findings. Next, a section describes the limitations of the results. A final section suggests topics for future research.

## Summary of the Results and Conclusions

This section first presents summaries of the results and conclusions with respect to the primary objectives of the study: to provide empirical information about six research questions. Each question (or group of questions) is presented below and is followed by a

TABLE 7-1

RESULTS OF MEAN SCORES

| Degrees of Association and Reliability Surrogates | Large Bank CBLOs (n=101) | Small Bank CEOs (n=29) | CPAs (n=120) |
|---|---|---|---|
| No CPA Association | | | |
| GAAP | .9 | .8 | .5 |
| Disclosures | .5 | .6 | .3 |
| Unintentional Error | .8 | .9 | .6 |
| Management Fraud | .6 | .7 | .4 |
| Employee Fraud | .5 | .8 | .5 |
| Compilation | | | |
| GAAP | 1.9 | 1.6 | 2.6 |
| Disclosures | 1.0 | 1.0 | 1.8 |
| Unintentional Error | 1.5 | 1.3 | 1.8 |
| Management Fraud | 1.0 | .9 | 1.2 |
| Employee Fraud | .9 | 1.0 | 1.1 |
| Independence | 2.1 | 2.0 | 3.4 |
| Review | | | |
| GAAP | 3.2 | 3.2 | 4.0 |
| Disclosures | 2.4 | 2.3 | 3.5 |
| Unintentional Error | 2.7 | 2.5 | 3.3 |
| Management Fraud | 2.2 | 2.3 | 2.4 |
| Employee Fraud | 2.0 | 2.2 | 2.3 |
| Independence | 3.4 | 3.3 | 4.6 |
| Audit | | | |
| GAAP | 4.5 | 4.6 | 5.2 |
| Disclosures | 4.0 | 3.9 | 5.0 |
| Unintentional Error | 4.1 | 4.0 | 4.8 |
| Management Fraud | 3.6 | 3.8 | 3.8 |
| Employee Fraud | 3.6 | 3.9 | 3.8 |
| Independence | 4.4 | 4.4 | 5.3 |

summary of the results and conclusions. Then, summaries of the results and conclusions with respect to secondary objectives of the study are presented.

Research Question Number 1: Do CPAs and users share similar views about the reliability of financial statements when there is no CPA association with the statements?

The mean scores shown in Table 7-1 indicate that, for each reliability surrogate, bankers placed more confidence in financial statements than CPAs did when there is no CPA association with the statements. The results of the statistical tests of hypotheses, however, demonstrate that none of these differences are significant. These findings suggest that CPAs and users share similar views about the reliability of financial statements when there is no CPA association with the statements. Furthermore, the mean scores for both CPAs and bankers are all below 1.0, indicating that both groups place almost no confidence in the reliability of financial statements prepared with no CPA association.

Research Question Number 2: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's compilation report?

Research Question Number 3: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's review report?

Research Question Number 4: Do CPAs and users share similar views about the reliability of financial statements when the statements are accompanied by the CPA's audit report?

The mean scores listed in Table 7-1 show that, for each reliability surrogate, CPAs placed more confidence in the reliability of the financial statements than bankers do when the statements are accompanied by the CPA's compilation report, review report, and audit report.[1] The results of the statistical tests of hypotheses further indicate that (1) differences for three reliability surrogates (GAAP, disclosures, independence) are significant with respect to compilation reports, and (2) differences with respect to four reliability surrogates (GAAP, disclosures, unintentional error, independence) are significant for review and audit reports.[2]

These results support the conclusion that CPAs and users do not share similar views about the reliability of financial statements when the statements are accompanied by compilation, review, or audit reports. When CPAs associate with and report on financial statements, users attribute less assurances to the reliability of the statements than CPAs. Three factors could cause bankers to place less confidence in the financial statements than CPAs. One is that bankers may be less familiar with the statements than CPAs because they do not understand the extent or nature of CPA procedures performed on the statements. For example, bankers may believe that the extent of CPA review procedures is less than that either required by SSARS #1 or actually performed by CPAs. Another factor is that bankers may be skeptical of any CPA assurances about the reliability of financial statements. Philosophical differences between CPAs and bankers may be responsible for this skepticism. A final factor is that CPAs may know that they achieve more assurances about the reliability of

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[1]An exception to these results was that small bank CEOs perceived more assurances about employee fraud in audits than CPAs.

[2]An exception to this result was that, in the comparison of CPAs to CEOs, the difference pertaining to GAAP was not significant for audits.

financial statements in compilation, review, and audit engagements than they express in related compilation, review, and audit reports.

Research Question Number 5: Do users perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

Research Question Number 6: Do CPAs perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report?

The mean scores shown in Table 7-1 indicate that both CPAs and bankers perceived increasing assurances about the reliability of financial statements as the degree of CPA association progresses from no association to compilation to review to audit. Further, Table 7-1 shows that CBLOs from large banks and CEOs from small banks perceived similarly the increasing assurances about the reliability of the statements. The results of the statistical tests of hypotheses demonstrate that all these differences are significant.[3] These findings support the conclusion that both CPAs and users perceive differences in the reliability of financial statements which are accompanied by no CPA report, by the CPA's compilation report, by the CPA's review report, and by the CPA's audit report. Furthermore, both CPAs and users correctly perceived that CPAs provide increasing assurances about the reliability of the statements in the order of compilation reports, review reports, and audit reports.

Another result pertains to CPAs' and bankers' confidence in

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[3]An exception to this result was that small bank CEOs' perceptions about the differences between no CPA association and compilations were not significant.

financial statements accompanied by the CPA's compilation report. First, the confidence bankers placed in compilations was more like the confidence placed in statements with no CPA association than the confidence placed in reviews. Consequently, bankers perceived that a CPA's compilation report provides almost no assurances about the financial statements. Since SSARS #1 requires CPAs to express no assurances about the financial statements in a compilation report, bankers apparently perceived accurately the intent of the CPA's compilation report. Second, unlike the bankers, CPAs placed some confidence in compiled financial statements. This finding suggests two possible explanations. One is that CPAs may know that they achieve some assurances about the financial statements, despite the denial of assurances contained in the compilation report. A second explanation is that CPAs may not understand compilation communication guidelines required by SSARS #1. For example, CPAs may believe that their responsibilities for compiled financial statements are greater than those required by SSARS #1. As another example, CPAs may believe that the assurances contained in the compilation report are greater than those intended by SSARS #1.

A final result concerns CPAs' and bankers' perceptions of a CPA's independence in compilations and reviews. The results first show that CPAs had medium confidence and bankers had weak confidence that CPAs are independent in compilations. The results next show that bankers had only medium confidence that CPAs are independent in reviews. These results appear to be contrary to the accounting profession's guidelines about independence found in SSARS #1. This standard requires a CPA to be independent in reviews and requires a

CPA to be independent in compilations unless specifically disclaimed in the compilation report. There are two possible explanations for this finding. One is that both CPAs and bankers perceive a CPA's independence as a function of the degree of association. A second possible reason is that both CPAs and bankers may be confused about the independence requirements contained in SSARS #1.

Secondary Objectives

Secondary objectives of the present study were to provide empirical information about the relative effects of the reliability surrogates and to measure respondents' familiarity with compilations and reviews. Each objective is presented below and followed by a summary of the results and conclusions.

One secondary objective was to investigate reliability surrogate effects, which refer to the respondents' relative evaluations of the reliability surrogates for each degree of association. The mean scores shown in Table 7-1 and the results of univariate t-tests of pair comparisons indicate that both CPAs and bankers consistently place (1) more confidence in GAAP and independence than in the other four reliability surrogates, and (2) less confidence in management fraud and employee fraud than in the other surrogates. Several conclusions can be drawn based on these results. First, both CPAs and users believe that a CPA's report on financial statements provides more assurances about GAAP than about the other reliability surrogates. Two possible reasons explain the higher levels of assurances perceived about GAAP. One is that both CPAs and bankers believe that CPAs achieve and express more assurances about GAAP than about the other reliability surrogates. Another reason is that CPAs and users are more familiar with GAAP due to previous experience or due to references to GAAP contained in the CPA's review and audit reports. Second, the higher levels of assurances about independence indicated by CPAs and users may be attributed to professional standards which require a CPA to be independent when associated with financial statements. Finally, the results concerning management fraud and employee fraud suggest that both CPAs and users believe that CPAs provide less assurances about fraud than about the other reliability surrogates. Three possible reasons explain this finding. One is that CPAs and bankers may believe that CPAs are not responsible for detecting the effects of either management or employee fraud. Another reason is that CPAs and bankers may believe that CPAs are not capable of detecting the effects of either management or employee fraud. A final reason is that fraud may be related more to the integrity of management personnel and employees than to financial statements.

The other secondary objective was to investigate the extent to which CPAs and users are familiar with compilations and reviews. Table 7-2 shows the percentages of large bank CBLOs, small bank CEOs, and CPAs who answered "yes" to six questions about their familiarity with compilations and reviews. The percentages shown in Table 7-2 first indicate that CPAs and large bank CBLOs are more familiar with compilations and reviews than small bank CEOs. Two reasons may explain this finding. One is that small bank CEOs may rely more on their familiarity with loan customers than on CPA reports as a basis for making loan decisions. Consequently, these CEOs may not need to use compilation reports and review reports. A second possible reason

TABLE 7-2

RESULTS OF FAMILIARITY QUESTIONS

| Familiarity Questions | Percentage of Large Bank CBLOs Answering "Yes" | Percentage of Small Bank CEOs Answering "Yes" | Percentage of CPAs Answering "Yes" |
|---|---|---|---|
| Have you read any materials about compilations and reviews? | 95.2% | 51.4% | 95.9% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by your bank (firm)? | 32.4% | 2.9% | 51.6% |
| Have you attended a seminar or educational workshop on compilations and reviews sponsored by an organization other than your bank (firm)? | 59.0% | 17.1% | 63.9% |
| Have you seen a CPA's compilation report accompanying the financial statements of any of your bank's customers (firm's clients)? | 74.3% | 54.3% | 73.8% |
| Have you seen a CPA's review report accompanying the financial statements of any of your bank's customers (firm's clients)? | 76.2% | 45.7% | 63.9% |
| Do you now use or expect to use in the future compilation reports or review reports prepared by CPAs (Do you now or in the future do you expect to participate in compilation or review engagements)? | 93.3% | 68.6% | 91.0% |

is that small banks may not have sufficient financial resources or time to justify education in the area of compilations and reviews. Next, the results show that a high percentage of all respondents report that they see compilation and review reports in practice, and expect to either use such reports or participate in such engagements. These results support two conclusions: (1) both CPAs and users are generally familiar with compilations and reviews, and (2) compilations and reviews are relevant to the loan decision process involving CPAs, the financial statements of nonpublic businesses, and bankers.

## Implications

A number of implications of the present study and its results are stated below. These implications represent the views of the researcher.

First, the findings support the Accounting and Review Services Committee's (ARSC's) successful implementation of an assurance level approach to CPA reports on financial statements of nonpublic businesses. This approach intends that CPAs provide increasing assurances about the financial statements in the order of compilation reports, review reports, and audit reports. The results of the present study support two aspects of this implementation. The results first indicate that both CPAs and users are generally familiar with compilations and reviews. This finding suggests that both accounting and banking professions have educated most of their members about compilations and reviews. Next, the results show that both CPAs and users correctly perceive that CPAs provide increasing assurances about the financial statements accompanied by compilation reports, review reports, and audit reports in that order.

Second, the finding that users perceive increasing assurances about the reliability of compiled, reviewed, and audited financial statements, in that order, replicates a general finding of previous research. That is, as the degree of CPA association with financial statements increases, users attribute more reliability to the statements.

Third, the results tend to mitigate the fears that users might attribute audit-type assurances to financial statements accompanied by compilation or review reports. Both the results of legal cases reviewed in Chapter III and the results of AICPA auditing standards reviewed in Chapter IV show that users attributed audit-type assurances to unaudited financial statements. Since SSARS #1 replaced unaudited financial statements with compilations and reviews, there is concern about whether users attribute audit-type assurances to compilation or review reports. The results of the present study indicate that, on the average, users do not attribute audit-type assurances to compilation or review reports. It is the researcher's opinion that this finding should also minimize the CPA's fear of the legal risks of unwarranted user reliance on financial statements in compilation or review engagements.

Fourth, the findings suggest a potential problem dealing with CPAs' and users' perceptions about a CPA's independence in compilations and reviews. As stated in Chapter I, the AICPA views independence as the cornerstone of its philosophical structure. In accordance with this view, SSARS #1 requires CPAs to be independent in reviews, and requires CPAs to be independent in compilations unless specifically disclaimer in the compilation report. The results indicate that the extent of both CPAs' and users' confidence in a CPA's independence was less than that expected. Perhaps the ARSC should examine the adequacy of its independence guidelines contained in SSARS #1. At the same time, perhaps the AICPA's Ethics Committee should examine the adequacy of independence guidelines with respect to unaudited financial statements contained in its Code of Professional Ethics.

Fifth, the results suggest a possible misunderstanding among both CPAs and users regarding the CPA's assurances about GAAP. As stated in Chapter I, GAAP refer to the conventions, rules, and procedures which define accepted accounting practice at a particular time. According to this definition, GAAP comprehend the adequacy of material disclosures and the avoidance of material unintentional errors. If GAAP comprehend disclosures and unintentional errors, it was expected that respondents would perceive a level of assurance about GAAP equal to or less than the level of assurance attributed to either disclosures or unintentional errors. However, the findings of the present study show that both CPAs and users perceive more assurances about GAAP than about either disclosures or unintentional errors. Therefore, CPAs and users may not understand the comprehensive nature of assurances implied by GAAP.

Sixth, the findings suggest that the ARSC and the Auditing Standards Board (ASB) continue to take a careful approach to establishing CPA responsibilities for fraud. The results of the present research indicate that both CPAs and users perceive less assurances about management fraud and employee fraud than about the other reliability surrogates. The results further suggest the possibility that fraud may be related more to the integrity of management personnel and employees than to financial statements. Finally, the results do not support a concern that users might perceive more assurances about fraud than CPAs do.

Seventh, the finding that bankers perceive almost no assurances about compilations may affect their demands for either compilations or reviews. This suggests that bankers may require CPAs to review loan customers' financial statements in order to receive some assurances about the statements.

Finally, the results of the present study indicate that the bank size does not appear to affect bankers' perceptions about the reliability of financial statements. Bankers from both large and small banks understand the different CPA assurances contained in compilation, review, and audit reports.

## Limitations of the Results

The results of the present research have several limitations. These include the scope and application of the study, the generalizability of results, the questionnaire, and respondents who are unfamiliar with compilations and reviews.

One limitation of the results is the scope and application of the study. The study is limited to: nonpublic businesses; historical annual financial statements; the CPA-banker communication process involving CPA written reports (compilation, review, unqualified audit); the context of the loan situation; and the specified aggregate meaning of "reliability."

A second limitation refers to the generalizability of the results. These results are generalizable only to (1) practicing Michigan CPAs who were members of the Michigan Association of Certified Public Accountants, (2) practicing Michigan CBLOs from large banks, and (3) practicing Michigan CEOs from small banks.

Two limitations of the questionnaire also limit the results of the present study. One is that the questionnaire measured perceptions of the reliability of financial statements. It did not measure respondents' actions or other decision-making behavior with respect to reliance on financial statements. A second aspect is that the questionnaire's reliability was not investigated.

Finally, the results represent the responses of CPAs and bankers who answered "yes" to at least one of the six familiarity questions on the questionnaire. The CPAs and bankers who answered "no" to all six of the familiarity questions were considered to be unfamiliar with compilations and reviews, and their responses were not used in the study. Therefore, the results do not represent the perceptions of CPAs or bankers who are not familiar with compilations and reviews.

## Suggestions for Future Research

Follow-up studies on various aspects of the present research can further explain the present findings or provide additional information about compilations and reviews. These topics are: variables in the present study which can be manipulated; the extent and nature of CPA procedures in compilations and reviews; a CPA's independence in compilations and reviews; and the costs and benefits of compilations and reviews.

Future studies can address the same research questions differently by manipulating variables found in the contents of the questionnaire. Variables that could be manipulated in the hypothetical loan situation are: the extent of the banker's familiarity with the loan customer and the loan customer's CPA firm; the extent of the CPA firm's familiarity with the client and the client's past financial statements; size of the CPA firm; terms of the loan agreement; and time period covered by the financial statements. Other studies can change the language of the CPA reports or modify the meaning of "reliability."

Another aspect is the extent and nature of CPA procedures performed on financial statements in compilations and reviews. One conclusion of the present study is that CPAs may know that they achieve more assurances about financial statements in compilations and reviews than they express in compilation and review reports. What is the extent and nature of CPA procedures performed on financial statements in compilations and reviews? Do these procedures comply with AICPA compilation and review standards? Do all CPAs practice similar procedures in compilation and review engagements? Future research can provide answers to these questions.

A potential problem disclosed by the present study is that CPAs and users believe that CPAs may not be as independent in compilations and reviews as they should be, according to AICPA compilation and review standards. Future research can explore this issue by investigating the adequacy of these standards and by surveying CPAs and users about their perceptions of a CPA's independence in compilations and reviews.

A final suggestion for future research concerns the costs and benefits of compilations and reviews. For example, an implication of the present study is that bankers may require CPAs to review loan customers' financial statements, in lieu of compiling them. Is the benefit to the banker of receiving some assurances about the financial statements greater than the cost of the loan customer of paying a CPA for a review of the statements? Are bankers requiring reviews instead of either compilations or audits? Do CPAs recommend to their clients that reviews replace audits? Studies about the costs and benefits of compilations and reviews can provide answers to these and similar questions.

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APPENDICES

# APPENDIX A

# BANK COVER LETTERS AND QUESTIONNAIRE

MICHIGAN STATE UNIVERSITY

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING · MICHIGAN · 48824

November 26, 1979

Compilations and reviews are new CPA services which have replaced unaudited financial statement engagements for nonpublicly-held companies. These new services have created much interest and concern among both bankers and CPAs. With any new professional standard, potential exists for different interpretations of that standard by various parties affected by its implementation. An important concern regarding compilations and reviews is that bankers and CPAs may perceive the value of the types of CPA reports differently, and subsequently assign different degrees of reliability to the financial statements.

I am conducting research at Michigan State University to study this problem. To investigate thoroughly the issues raised, I am seeking the views of bankers and CPAs on this matter. As a lending institution, your bank's input on how compilations and reviews affect your reliance on financial statements is particularly important to this research. To include your responses as part of the study's results, please complete the enclosed questionnaire and return it at your earliest convenience. If someone at your bank is interested in and familiar with compilations and reviews, please forward this questionnaire to that person and encourage his or her participation in this research. Based on pretests, the questionnaire can be completed in less than twenty minutes.

The person responding may be assured of confidentiality. The data will be summarized, analyzed, and reported only in the aggregate form. The identification number on the questionnaire will be used to check your name off of the mailing list when the questionnaire is returned.

The aggregate results and policy recommendations derived therefrom will be made available to Robert Morris Associates' Accounting Policy Committee, appropriate accounting groups, and other interested parties. You may receive a summary of the results by printing your name and address on the back of the return envelope.

I would be most happy to answer any questions you might have. Please write or call. The telephone number is (517) 792-3927.

Thank you for your assistance.

Sincerely,

Larry J. Rankin
Research Director

# RELIANCE ON SMALL BUSINESS FINANCIAL STATEMENTS

A Study of Michigan Bankers' and Accountants'
Perceptions of Compilations, Reviews, and Audits

This survey will help me to develop an understanding of how bankers and accountants rely on financial statements which have been compiled, reviewed, audited, or not reported on by a CPA. Please answer all the questions. If you wish to comment on any questions or qualify your answers, please feel free to use the space in the margins or page twelve of this questionnaire.

Thank you for your help.

Department of Accounting and Financial Administration
Graduate School of Business Administration
Michigan State University
East Lansing, Michigan 48824

2

First, I would like to ask a few questions about your familiarity with Compilation and Review. (Circle the number of each appropriate answer)

1. Have you read any materials about Compilation and Review?

   1 YES
   2 NO

2. Have you attended a seminar or educational workshop on Compilation and Review sponsored by your bank?

   1 YES
   2 NO

3. Have you attended a seminar or educational workshop on Compilation and Review sponsored by an organization other than your bank?

   1 YES
   2 NO

4. Have you seen a CPA's Compilation report accompanying the financial statements of any of your bank's customers?

   1 YES
   2 NO

5. Have you seen a CPA's Review report accompanying the financial statements of any of your bank's customers?

   1 YES
   2 NO

6. Do you now or expect to utilize a CPA's Compilation or Review reports?

   1 YES
   2 NO

3

The following situation is a hypothetical case involving a small nonpublic business, a CPA, and a commercial banker. It is provided as a frame of reference for your subsequent responses.

Assume that C. M. Smith & Co., a reputable CPA firm, is engaged by Jones Manufacturing Company, a small nonpublic business, to perform CPA services associated with Jones's financial statements. The financial statements, which are for the year ended October 31, 1979, include a Balance Sheet, Income Statement, Statement of Owner's Capital, and Statement of Changes in Financial Position. Assume that the 10/31/79 Balance Sheet reflects the following:

| | | | |
|---|---|---|---|
| Current Assets | $330,000 | Total Liabilities | $200,000 |
| Noncurrent Assets | $170,000 | Owner's Capital | $300,000 |
| | $500,000 | | $500,000 |

The 10/31/79 Income Statement reflects $50,000 net income after taxes earned during the year. Assume that C.M. Smith & Co. is not previously experienced with Jones Manufacturing Company financial statements.

The CPA engagement will provide CPA-associated financial statements, which will partially comprise Jones's application for a $50,000 short-term, unsecured, commercial bank cash loan. Assume that the bank loan officer is not previously experienced with either Jones Manufacturing Company or C. M. Smith & Co. The banker utilizes the financial statements and CPA's report to facilitate the loan decision.

Next, I will provide you with four hypothetical situations representing different levels of CPA association with financial statements. Following each situation, you will have the opportunity to evaluate various aspects of reliance on financial statements. Please answer all questions.

4

Please read the following AUDIT report and rate the six numbered items below.

To Jones Manufacturing Company:

We have examined the balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Jones Manufacturing Company as of October 31, 1979, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

November 30, 1979

C. M. Smith & Co.
Certified Public Accountants

5

Given the above AUDIT report, how confident are you that the Jones financial statements are likely to be: (Place a ✓ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

6

Please read the following COMPILATION report and rate the six numbered items below.

To Jones Manufacturing Company:

The accompanying balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended have been compiled by us.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

November 30, 1979

C. M. Smith & Co.
Certified Public Accountants

7

Given the above COMPILATION report, how confident are you that the Jones financial statements are likely to be: (Place a √ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

8

Please read the following REVIEW report and rate the six numbered items below.

To Jones Manufacturing Company:

We have reviewed the accompanying balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

November 30, 1979 — C. M. Smith & Co.
Certified Public Accountants

9

Given the above REVIEW report, how confident are you that the Jones financial statements are likely to be: (Place a ✓ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

10

Given NO CPA ASSOCIATION and NO REPORT, how confident are you that the Jones financial statements are likely to be: (Place a ✓ in applicable box for each question)

| | | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|---|
| 1. | In conformity with generally accepted accounting principles? | | | | | | | |
| 2. | Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. | Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 4. | Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 5. | Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

Finally, I would like to ask a few demographic questions to help with the analysis of the data. (Circle the number of each appropriate answer)

1. What is your position within your bank?

   1 PRESIDENT
   2 SENIOR VICE-PRESIDENT
   3 VICE-PRESIDENT
   4 ASSISTANT VICE-PRESIDENT
   5 LOAN OFFICER
   6 CREDIT MANAGER
   7 CREDIT ANALYST
   8 OTHER (please specify) ________________

2. How long have you worked in commercial banking?

   1 LESS THAN 6 YEARS
   2 6 TO 10 YEARS
   3 11 TO 15 YEARS
   4 16 TO 20 YEARS
   5 OVER 20 YEARS

3. What is your age?

   1 LESS THAN 30 YEARS
   2 30 TO 39 YEARS
   3 40 TO 49 YEARS
   4 50 TO 59 YEARS
   5 OVER 59 YEARS

4. Which is the highest level of education that you have completed?

   1 COMPLETED HIGH SCHOOL
   2 SOME COLLEGE
   3 COMPLETED COLLEGE
   4 SOME GRADUATE WORK
   5 A GRADUATE DEGREE (specify degree) ________
   6 OTHER (please specify) ________________

**Is there anything else you would like to tell me about compilations, reviews, and audits? If so, please use this space for that purpose.**

---

**Your contribution to this research effort is greatly appreciated. If you would like a summary of the results, please print your name and address on the back of the return envelope (NOT on this questionnaire).**

# APPENDIX B

# CPA COVER LETTER AND QUESTIONNAIRE

MICHIGAN STATE UNIVERSITY

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING • MICHIGAN • 48824

November 26, 1979

Compilations and reviews are new CPA services which have replaced unaudited financial statement engagements for nonpublicly-held companies. These new services have created much interest and concern among both CPAs and bankers. With any new professional standard, potential exists for different interpretations of that standard by various parties affected by its implementation. An important concern regarding compilations and reviews is that CPAs and bankers may perceive the value of the types of CPA reports differently, and subsequently assign different degrees of reliability to the financial statements.

I am conducting research at Michigan State University to study this problem. To investigate thoroughly the issues raised, I am seeking the views of CPAs and bankers on this matter. As a practicing CPA, your input on how compilations and reviews affect your opinion as to the reliability of financial statements is particularly important to this research. To include your responses as part of the study's results, please complete the enclosed questionnaire and return it at your earliest convenience. Based on pretests, the questionnaire can be completed in less than twenty minutes.

You may be assured of confidentiality. The data will be summarized, analyzed, and reported only in the aggregate form. The identification number on the questionnaire will be used to check your name off of the mailing list when the questionnaire is returned.

The aggregate results and policy recommendations therefrom will be made available to MACPA, AICPA's Accounting and Review Service Committee, and other interested parties. You may receive a summary of the results by printing your name and address on the back of the return envelope.

I would be most happy to answer any questions you might have. Please write or call. The telephone number is (517) 792-3927.

Thank you for your assistance.

Sincerely,

Larry J. Rankin
Research Director

**RELIANCE ON SMALL BUSINESS FINANCIAL STATEMENTS**

**A Study of Michigan Bankers' and Accountants' Perceptions of Compilations, Reviews, and Audits**

**This survey will help me to develop an understanding of how bankers and accountants rely on financial statements which have been compiled, reviewed, audited, or not reported on by a CPA. Please answer all the questions. If you wish to comment on any questions or qualify your answers, please feel free to use the space in the margins or page twelve of this questionnaire.**

**Thank you for your help.**

**Department of Accounting and Financial Administration**
Graduate School of **Business Administration**
Michigan State University
**East Lansing, Michigan 48824**

2

First, I would like to ask a few questions about your familiarity with Compilation and Review. (Circle the number of each appropriate answer)

1. Have you read any materials about Compilation and Review?

   1 YES
   2 NO

2. Have you attended a seminar or educational workshop on Compilation and Review sponsored by your firm?

   1 YES
   2 NO

3. Have you attended a seminar or educational workshop on Compilation and Review sponsored by an organization other than your firm?

   1 YES
   2 NO

4. Have you seen a CPA's Compilation report accompanying the financial statements of any of your firm's clients?

   1 YES
   2 NO

5. Have you seen a CPA's Review report accompanying the financial statements of any of your firm's clients?

   1 YES
   2 NO

6. Do you now or expect to participate in Compilation or Review engagements?

   1 YES
   2 NO

3

The following situation is a hypothetical case involving a small nonpublic business, a CPA, and a commercial banker. It is provided as a frame of reference for your subsequent responses.

Assume that C. M. Smith & Co., a reputable CPA firm, is engaged by Jones Manufacturing Company, a small nonpublic business, to perform CPA services associated with Jones's financial statements. The financial statements, which are for the year ended October 31, 1979, include a Balance Sheet, Income Statement, Statement of Owner's Capital, and Statement of Changes in Financial Position. Assume that the 10/31/79 Balance Sheet reflects the following:

| | | | |
|---|---|---|---|
| Current Assets | $330,000 | Total Liabilities | $200,000 |
| Noncurrent Assets | $170,000 | Owner's Capital | $300,000 |
| | $500,000 | | $500,000 |

The 10/31/79 Income Statement reflects $50,000 net income after taxes earned during the year. Assume that C.M. Smith & Co. is not previously experienced with Jones Manufacturing Company financial statements.

The CPA engagement will provide CPA-associated financial statements, which will partially comprise Jones's application for a $50,000 short-term, unsecured, commercial bank cash loan. Assume that the bank loan officer is not previously experienced with either Jones Manufacturing Company or C. M. Smith & Co. The banker utilizes the financial statements and CPA's report to facilitate the loan decision.

Next, I will provide you with four hypothetical situations representing different levels of CPA association with financial statements. Following each situation, you will have the opportunity to evaluate various aspects of reliance on financial statements. Please answer all questions.

4

Please read the following AUDIT report and rate the six numbered items below.

To Jones Manufacturing Company:

We have examined the balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Jones Manufacturing Company as of October 31, 1979, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

November 30, 1979

C. M. Smith & Co.
Certified Public Accountants

5

Given the above AUDIT report, how confident are you that the Jones financial statements are likely to be: (Place a √ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

6

Please read the following COMPILATION report and rate the six numbered items below.

To Jones Manufacturing Company:

The accompanying balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended have been compiled by us.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

November 30, 1979

C. M. Smith & Co.
Certified Public Accountants

7

Given the above COMPILATION report, how confident are you that the Jones financial statements are likely to be: (Place a √ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

8

Please read the following REVIEW report and rate the six numbered items below.

To Jones Manufacturing Company:

We have reviewed the accompanying balance sheet of Jones Manufacturing Company as of October 31, 1979, and the related statements of income, owner's capital, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

November 30, 1979

C. M. Smith & Co.
Certified Public Accountants

9

Given the above REVIEW report, how confident are you that the Jones financial statements are likely to be: (Place a ✓ in applicable box for each question)

| | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|
| 1. In conformity with generally accepted accounting principles? | | | | | | | |
| 2. Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. Evaluated by a CPA who is independent of Jones Manufacturing? | | | | | | | |
| 4. Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 5. Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 6. Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

10

**Given NO CPA ASSOCIATION and NO REPORT, how confident are you that the Jones financial statements are likely to be:** (Place a ✓ in applicable box for each question)

| | | No Confidence | Very Weak Confidence | Weak Confidence | Medium Confidence | Strong Confidence | Very Strong Confidence | Complete Confidence |
|---|---|---|---|---|---|---|---|---|
| 1. | In conformity with generally accepted accounting principles? | | | | | | | |
| 2. | Free of the effects of an existing material unintentional error (i.e. clerical or misapplication of an accounting principle)? | | | | | | | |
| 3. | Free of the effects of an existing material management fraud (i.e. management's intentional misappropriation of assets or falsification of records)? | | | | | | | |
| 4. | Accompanied by all material disclosures (i.e. contingent liability described in note or footnote to financial statements)? | | | | | | | |
| 5. | Free of the effects of an existing material employee fraud (i.e. employee's intentional misappropriation of assets or falsification of records)? | | | | | | | |

Finally, I would like to ask a few demographic questions to help with the analysis of the data. (Circle the number of each appropriate answer)

1. What is your area of specialty within your CPA firm?

   1 AUDIT
   2 TAX
   3 MANAGEMENT SERVICES
   4 OTHER (please specify) ________

2. What is your position within your CPA firm?

   1 PARTNER
   2 MANAGER
   3 SUPERVISOR
   4 SENIOR
   5 STAFF ACCOUNTANT/JUNIOR
   6 OTHER (please specify) ________

3. What is the size of your CPA firm?

   1 SOLE PRACTITIONER
   2 LOCAL FIRM (MICHIGAN OFFICES ONLY)
   3 REGIONAL FIRM (INTERSTATE OFFICES)
   4 INTERNATIONAL/NATIONAL

4. How long have you worked in public accounting?

   1 LESS THAN 6 YEARS
   2 6 TO 10 YEARS
   3 11 TO 15 YEARS
   4 16 TO 20 YEARS
   5 OVER 20 YEARS

5. What is your age?

   1 LESS THAN 30 YEARS
   2 30 TO 39 YEARS
   3 40 TO 49 YEARS
   4 50 TO 59 YEARS
   5 OVER 59 YEARS

6. Which is the highest level of education that you have completed?

   1 COMPLETED HIGH SCHOOL
   2 SOME COLLEGE
   3 COMPLETED COLLEGE
   4 SOME GRADUATE WORK
   5 A GRADUATE DEGREE (specify degree) ________
   6 OTHER (please specify) ________

Is there anything else you would like to tell me about compilations, reviews, and audits? If so, please use this space for that purpose.

Your contribution to this research effort is greatly appreciated. If you would like a summary of the results, please print your name and address on the back of the return envelope (NOT on this questionnaire).

# APPENDIX C

## BANKER AND CPA FOLLOW-UP POSTCARDS AND COVER LETTERS

December 3, 1979

Last week a questionnaire seeking your views on compilations and reviews was mailed to you.

If you have already completed and returned the questionnaire, please accept my sincere thanks. If not, please do so today. It is extremely important that your views on compilations and reviews be included in the study's results.

If you did not receive the questionnaire or it got misplaced, please call me collect (517) 792-3927, and I will send another one to you.

Sincerely,

Larry J. Rankin
Research Director

December 3, 1979

Last week a questionnaire seeking your bank's views on compilations and reviews was mailed to you.

If you or another banker have already completed and returned the questionnaire, please accept my sincere thanks. If not, please do so today. It is extremely important that your bank's views on compilations and reviews be included in the study's results.

If you did not receive the questionnaire or it got misplaced, please call me collect (517) 792-3927, and I will send another one to you.

Larry J. Rankin
Research Director

MICHIGAN STATE UNIVERSITY



GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING · MICHIGAN · 48824

December 17, 1979

About three weeks ago I wrote to you seeking your views on compilations and reviews. I have not yet received your completed questionnaire.

Compilations and reviews are new CPA services which have replaced unaudited financial statement engagements for nonpublicly-held companies. An important concern regarding compilations and reviews is that bankers and CPAs may perceive the value of the types of CPA reports differently, and subsequently assign different degrees of reliability to the financial statements. To investigate this issue, I am seeking the views of bankers and CPAs.

As a practicing loan officer, your input on how compilations and reviews affect your reliance on financial statements is particularly important to this research. To include your responses as part of the study's results, please complete and return the enclosed questionnaire. Based on pretests, the questionnaire can be completed in less than twenty minutes.

I would be most happy to answer any questions you might have. Please write or call. The telephone number is (517) 792-3927.

Thank you for your assistance.

Sincerely,

Larry J. Rankin
Research Director

MICHIGAN STATE UNIVERSITY

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING · MICHIGAN · 48824

December 17, 1979

About three weeks ago I wrote to you seeking your bank's views on compilations and reviews. I have not yet received your bank's completed questionnaire.

Compilations and reviews are new CPA services which have replaced unaudited financial statement engagements for nonpublicly-held companies. An important concern regarding compilations and reviews is that bankers and CPAs may perceive the value of the types of CPA reports differently, and subsequently assign different degrees of reliability to the financial statements. To investigate this issue, I am seeking the views of bankers and CPAs.

As a lending institution, your bank's input on how compilations and reviews affect your reliance on financial statements is particularly important to this research. To include your responses as part of the study's results, please complete and return the enclosed questionnaire. If someone at your bank is interested in and familiar with compilations and reviews, please have him or her complete and return the enclosed questionnaire. Based on pretests, the questionnaire can be completed in less than twenty minutes.

I would be most happy to answer any questions you might have. Please write or call. The telephone number is (517) 792-3927.

Thank you for your assistance.

Sincerely,

Larry J. Rankin
Research Director

MICHIGAN STATE UNIVERSITY

GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING · MICHIGAN · 48824

December 17, 1979

About three weeks ago I wrote to you seeking your views on compilations and reviews. I have not yet received your completed questionnaire.

Compilations and reviews are new CPA services which have replaced unaudited financial statement engagements for nonpublicly-held companies. An important concern regarding compilations and reviews is that CPAs and bankers may perceive the value of the types of CPA reports differently, and subsequently assign different degrees of reliability to the financial statements. To investigate this issue, I am seeking the views of CPAs and bankers.

As a practicing CPA, your input on how compilations and reviews affect your opinion as to the reliability of financial statements is particularly important to this research. To include your responses as part of the study's results, please complete and return the enclosed questionnaire. Based on pretests, the questionnaire can be completed in less than twenty minutes.

I would be most happy to answer any questions you might have. Please write or call. The telephone number is (517) 792-3927.

Thank you for your assistance.

Sincerely,

Larry J. Rankin
Research Director

MICHIGAN STATE UNIVERSITY



GRADUATE SCHOOL OF BUSINESS ADMINISTRATION
DEPARTMENT OF ACCOUNTING & FINANCIAL ADMINISTRATION

EAST LANSING • MICHIGAN • 48824

January 24, 1980

A researcher I am working with at Michigan State University is seeking the views of practicing CPAs and bank loan officers regarding compilations and reviews. I believe this research is important to continue trying to resolve the problems of unaudited financial statements.

Please take about fifteen minutes to complete and return the enclosed questionnaire. As supervisor of this research, I believe that your responses are essential to the study's results. The research will contribute important knowledge to the accounting and banking professions.

If you have any questions, please call Larry Rankin collect at (517) 792-3927.

Thank you for your assistance.

Sincerely,

Alvin A. Arens

Dr. Alvin A. Arens
Professor of Accounting

# APPENDIX D

# BANKER DEMOGRAPHIC DATA

TABLE D-1

PROFESSIONAL TITLES OF RESPONDING BANKERS

| Professional Title | Large Banks: Number of Respondents | Large Banks: Percentage of Respondents | Small Banks: Number of Respondents | Small Banks: Percentage of Respondents |
|---|---|---|---|---|
| President | 2 | 2.0% | 14 | 48.3% |
| Senior Vice-President | 7 | 6.9 | 3 | 10.3 |
| Divisional Vice-President | 1 | 1.0 | - | - |
| Vice-President | 32 | 31.7 | 7 | 24.1 |
| Assistant Vice-President | 17 | 16.8 | 1 | 3.5 |
| Loan Officer | 13 | 12.9 | 2 | 6.8 |
| Credit Manager | 6 | 5.9 | - | - |
| Credit Analyst | 21 | 20.8 | - | - |
| Branch Manager | 2 | 2.0 | - | - |
| Auditor | - | - | 1 | 3.5 |
| Cashier | - | - | 1 | 3.5 |
| Total | 101 | 100.0% | 29 | 100.0% |

TABLE D-2

SIZE OF BANK REPRESENTED BY RESPONDING BANKERS

| Bank Total Assets (Millions of Dollars) | Large Banks | | Small Banks | |
|---|---|---|---|---|
| | Number of Respondents | Percentage of Respondents | Number of Respondents | Percentage of Respondents |
| Less than 25 | - | - | 12 | 41.4% |
| 25-49 | - | - | 12 | 41.4 |
| 50-99 | - | - | 5 | 17.2 |
| 100-500 | 51 | 50.5% | - | - |
| Over 500 | 50 | 49.5 | - | - |
| Total | 101 | 100.0% | 29 | 100.0% |

TABLE D-3

COMMERCIAL BANKING EXPERIENCE OF RESPONDING BANKERS

| Number of Years of Commercial Banking Experience | Large Banks | | Small Banks | |
|---|---|---|---|---|
| | Number of Respondents | Percentage of Respondents | Number of Respondents | Percentage of Respondents |
| Less than 6 | 43 | 42.6% | 3 | 10.3% |
| 6-10 | 21 | 20.8 | 5 | 17.3 |
| 11-15 | 17 | 16.8 | 6 | 20.7 |
| 16-20 | 9 | 8.9 | 7 | 24.1 |
| Over 20 | 11 | 10.9 | 8 | 27.6 |
| Total | 101 | 100.0% | 29 | 100.0% |

TABLE D-4

AGE OF RESPONDING BANKERS

| Age in Years | Large Banks: Number of Respondents | Large Banks: Percentage of Respondents | Small Banks: Number of Respondents | Small Banks: Percentage of Respondents |
|---|---|---|---|---|
| Less than 30 | 36 | 35.7% | 1 | 3.5% |
| 30-39 | 38 | 37.6 | 11 | 37.9 |
| 40-49 | 18 | 17.8 | 7 | 24.1 |
| 50-59 | 8 | 7.9 | 9 | 31.0 |
| Over 59 | 1 | 1.0 | 1 | 3.5 |
| Total | 101 | 100.0% | 29 | 100.0% |

TABLE D-5

EDUCATION OF RESPONDING BANKERS

| Highest Educational Level Completed | Large Banks: Number of Respondents | Large Banks: Percentage of Respondents | Small Banks: Number of Respondents | Small Banks: Percentage of Respondents |
|---|---|---|---|---|
| High School | 2 | 2.0% | 3 | 10.3% |
| Some College Work | 14 | 13.8 | 9 | 31.1 |
| Bachelor's Degree | 29 | 28.7 | 8 | 27.6 |
| Some Graduate Work | 24 | 23.8 | 6 | 20.7 |
| Graduate Degree | 32 | 31.7 | 3 | 10.3 |
| Total | 101 | 100.0% | 29 | 100.0% |

# APPENDIX E

## CPA DEMOGRAPHIC DATA

TABLE E-1

PROFESSIONAL TITLES OF CPA RESPONDENTS

| Professional Title | Number of Respondents | Percentage of Respondents |
|---|---|---|
| Owner | 10 | 8.4% |
| Partner | 74 | 61.7 |
| Manager | 21 | 17.5 |
| Supervisor | 7 | 5.8 |
| Senior | 5 | 4.2 |
| Staff Accountant/Junior | 1 | .8 |
| Other | 1 | .8 |
| No Response | 1 | .8 |
| Total | 120 | 100.0% |

TABLE E-2

TYPE OF FIRM REPRESENTED BY CPA RESPONDENTS

| Type of Firm | Number of Respondents | Percentage of Respondents |
|---|---|---|
| Sole Practice | 17 | 14.2% |
| Local Firm | 71 | 59.2 |
| Regional Firm | - | - |
| National/International Firm | 31 | 25.8 |
| No Response | 1 | .8 |
| Total | 120 | 100.0% |

TABLE E-3

SPECIALTY AREA OF CPA RESPONDENTS

| Specialty Area | Number of Respondents | Percentage of Respondents |
|---|---|---|
| Audit | 47 | 39.2% |
| Tax | 20 | 16.7 |
| Management Services | 12 | 10.0 |
| Audit and Tax | 10 | 8.3 |
| Audit and Management Services | 2 | 1.7 |
| Tax and Management Services | 4 | 3.3 |
| Audit, Tax, and Management Services | 21 | 17.5 |
| Other | 3 | 2.5 |
| No Response | 1 | .8 |
| Total | 120 | 100.0% |

TABLE E-4

PUBLIC ACCOUNTING EXPERIENCE OF CPA RESPONDENTS

| Number of Years of Public Accounting Experience | Number of Respondents | Percentage of Respondents |
|---|---|---|
| Less than 6 | 16 | 13.3% |
| 6-10 | 31 | 25.8 |
| 11-15 | 29 | 24.2 |
| 16-20 | 18 | 15.0 |
| Over 20 | 25 | 20.8 |
| No Response | 1 | .9 |
| Total | 120 | 100.0% |

TABLE E-5

AGE OF CPA RESPONDENTS

| Age in Years | | Number of Respondents | Percentage of Respondents |
|---|---|---|---|
| Less than 30 | | 19 | 15.8% |
| 30-39 | | 55 | 45.8 |
| 40-49 | | 22 | 18.3 |
| 50-59 | | 14 | 11.7 |
| Over 59 | | 8 | 6.7 |
| No Response | | 2 | 1.7 |
| | Total | 120 | 100.0% |

TABLE E-6

EDUCATION OF CPA RESPONDENTS

| Highest Educational Level Completed | | Number of Respondents | Percentage of Respondents |
|---|---|---|---|
| High School | | - | - |
| Some College Work | | 7 | 5.8% |
| Bachelor's Degree | | 59 | 49.2 |
| Some Graduate Work | | 19 | 15.8 |
| Graduate Degree | | 34 | 28.3 |
| No Response | | 1 | .9 |
| | Total | 120 | 100.0% |