



SCHOOL OF BUSINESS

University of Wisconsin-Madison

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Mr. Arthur Levitt, Jr.
Mr. Don Nicolaisen
Advisory Committee on the Accounting Profession
Office of Financial Institutions Policy, Room 1418
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Levitt and Mr. Nicolaisen,

The issues the Committee is addressing are important and are worthy of considerable thought and study. We urge the committee to spend whatever time is necessary to reach fully considered recommendations on these important issues. We have spent most of our career in the academic arena, although both of us have had considerable experience in accounting and auditing standard setting. Most of our comments relate to the educational questions raised in the discussion outline. However, given our experience in other areas of the profession, we also comment on some other areas. We have labeled our responses to the numbering system in the discussion outline.

2.4: Consider the state of accounting education and CPA licensing requirements.

There are a number of interesting questions under this section. We briefly address each of the issues:

Technical Standards vs. Multi-disciplinary approach. The manner in which the question is posed implies that universities (or the total U.S. accounting academy) are doing one or the other. Such a presumption is incorrect. Both of us have served on the Executive Committee and/or other leadership roles in the American Accounting Association and have been involved in curricula development at our institution throughout our career. Most major business schools emphasize a multi-disciplinary approach in the accounting curricula, coupled with sufficient technical standards, such that students will be able to understand the accounting, socio-economic, and business issues when they enter the profession.

As an example, during our program, a student receives 30 credits of accounting out of 120 required for an undergraduate degree. The students are required to take broadening life-development courses during their first two years and a variety of business courses in their third and fourth years. We have specifically developed our Masters of Accountancy Program in such a way to better develop the student's understanding of both the broad issues as well as the more narrow accounting considerations.

We are very proud of our Masters of Accountancy Program (MAcc) that provides an opportunity for our students to develop an integrated 150 credit hour program to enter the profession. Some elements of the program that has led to great success (100% placement, excellent feedback from employers and from students), include:

- A formal internship that requires analysis of an important topical area in addition to formal work experience.
- A unique 3 credit, three week course occurring after the internship program to build on the internship experience and to address practice issues in greater depth.
- The use of guest speakers throughout the curricula, including individuals from both large and small public accounting firms, industry, and others.
- A formal ethics program that occurs outside of course work.
- A limit of accounting courses to no more than 15 of the 30 credits of graduate work.
- An emphasis on tailoring the graduate curriculum to students' interests that are based on firm and industry experience. We regularly suggest our students take courses in such areas as financial instruments, supply-chain management, and risk.

It is clear that accounting programs continue to evolve such that students better understand both business and the economics of transactions. However, we also need to recognize that business is much more complex than a decade ago and that some technical training is required to understand the rationale for many accounting treatments. It is one thing to say that we should have 'fair value accounting' and another thing to understand how accountants can consistently determine 'fair value'. Further, it is important to understand how the FASB, as well as the IASB, have dealt with this very difficult issue.

Teaching Ethical Standards

The Discussion document states that the committee *should consider what approach teaches high ethical standards*. We believe this statement is misplaced for three reasons:

- Neither approach, per se, is designed to teach higher ethical standards,
- We must recognize that ethical standards begin outside of the classroom, i.e. it begins with one's family, their values, their religious upbringing, and so forth, and
- Many of the problems that exist today are related to financial rewards. Thus, it is not meaningful to consider ethics without considering financial and other incentives and how people behave in response to these incentives.

Our program at the University of Wisconsin has been similar to most college programs regarding ethics. We require courses at the sophomore level that relate to the philosophy of ethics.

We take two additional approaches that enhance discussion of ethics:

- Ethical issues and cases are integrated through the accounting curricula; particularly in the audit, intermediate, and tax courses.
- Ethics is integrated into our Five-Year Professional Program in Accounting beyond classroom experience.

It is the latter ethics experience that really distinguishes our program from others. We have included some elements of the program through a reference to our web page that brings ethics alive for the students.

http://www.bus.wisc.edu/accounting/resources_for_students/Ethics%20general/ethics%20PwC.asp . We reference this program because we believe that a Five-year integrated program, such as ours, has the ability to bring ethical understanding to the next level. For example, in the ethics program, the faculty (and others), can strongly debate ethical decisions without fear that it will affect their grades. Some of the major elements of the program include:

- An ethics experience between their junior and senior year. This includes reading a book such as *Final Accounting*, or *Smartest Men in the Room*, interviewing someone about how they make ethical decisions, and analyzing a number of questions that we pose.
- Responsibility for developing and enforcing a Code of Ethics for the Five-Year program, including assisting faculty regarding decisions that relate to cheating within the program (or before students are interviewed to enter the program),
- Major Ethical Symposia held at least once a year.

During the past two years, we had Ira Chaleff, author of the book, *The Courageous Follower*, who keynoted a discussion of the importance of challenging our leaders in a constructive

fashion.. We also organized a panel on the ethics of taxation. The panel included a professor from Wayne State University, the Director of Taxation from Best Buy, and national partners in taxation from both Grant Thornton and PricewaterhouseCoopers. After introductory remarks, students were paired with faculty and practitioners and discussed current topics such as Wal-Mart's techniques to avoid paying real estate taxes and a transfer pricing case.

We have found that this program works because students (a) assume responsibility for the ethical behavior of their class as a whole, (b) can personalize ethical issues when they interview leaders, (c) interact with practitioners and leaders in relevant ethical topics that are occurring in business every year. One of our faculty members has followed up with independent research to determine whether such a program makes a difference – and it does!

2.4 The 150 Credit Hour Program

We find two issues identified as germane to this topic: (2.4.1.2.4) *consider the impact of the 150-hour requirement upon the recruitment of undergraduates as accounting majors*, and (2.4.1.2.5) *consider whether the 150-hour requirement has improved audit quality*. The first question is fairly easy to answer for the University of Wisconsin- Madison. That answer is that we have unprecedented demand for our program. However, the demand for the program, in our view, stems from the challenges of the profession and the student's perceptions of the skills needed to excel in the profession. Certainly higher starting salaries have also helped.

We started our Five-year Professional Program in Accounting before the State of Wisconsin, or any of the adjoining states where we have high placement (Illinois and Minnesota) required 150 credits. While many students would always prefer less time in school (and less cost), we found that we were able to effectively grow the program because of (a) the value we add in topics and experience, (b) the placement of our graduates, and (c) the positive feedback we received from public accounting firms that hire our graduates.

Students now view an accounting program as more prestigious to enter than it was a decade ago. Our students have a greater sense of the difficulties that the profession faces, including the complexity of both accounting and auditing. That prestige is complemented by a value-added graduate degree. However, the numbers might not be as large as indicated by an *Issues in Accounting Education* article¹ that others will bring to your attention. But, we must also recognize that accounting is a more difficult profession because the items we are challenged to account for have become increasingly complex. Thus, our view is that the quality of students that we see is outstanding.

¹ Arthur Allen and Angela M. Woodland, "The 150 – Hour Requirement and the Number of CPA Exam Candidates, Pass Rates, and the Number Passing", *Issues in Accounting Education*, Vol. 21, No. 3, August 2006, pp. 173-193.

Has the 150 Credit Hour Requirement Improved Audit Quality?

We have not seen empirical research that has directly addressed this question. The feedback we received from the firms as we grew our program was as follows:

- During the initial phases of our program the firms had not changed their audit approach, or their career planning approach to take advantage of the new skill sets that students had brought to the table.
- More recently, students have been given more challenging work earlier in their career and the ability to exercise judgment. The students believe the work is more interesting and they feel more empowered to improve the audit process.
- The feedback we receive from the firms has been very positive regarding our students' increased contributions to the audits that they serve on.

We might suggest approaching this question in a slightly different way by looking at issues that are covered in a well-formulated graduate program that would not be covered in a traditional undergraduate program. We will provide one example that is relevant to current topics. The graduate auditing class has an in-depth assignment on auditing fair value measurements ranging from determining the appropriate basis for mortgage servicing rights at Wells Fargo to valuing impairments at Ford Motor Company when that company made a strategic decision to downsize. Areas covered in the assignment include impairments of net property plant and equipment, intangibles and goodwill, financing receivables, property held for resale, and marketable securities (including some where the market is very thin). Similarly students in Professor Warfield's graduate accounting course are preparing in-depth papers on leases, pensions, goodwill, other post employment benefits, stock based compensation, foreign currency translation – each of which requires examination of fair value issues as well as other conceptual challenges (e.g., recognition versus disclosure). The nature of these assignments is to get students thinking in more depth where greater judgment is going to be required as the profession faces the challenges of the next decade.

Thus, our statement on the value of the 150 credit hour programs to audit quality is as follows: If you believe the complexity of accounting and the need for more judgment in accounting is going to continue to increase, then we believe the only conclusion that can be justified is that the profession needs well formulated 5-year professional programs in accounting. We emphasize well-formulated programs because a program that is simply 150 credit hours without adding such value and responding to future practice demands does not address the quality issue. On the other hand, if you believe that accounting is going to revert to a set of rules that will be uniformly applied in every circumstance, regardless of the economics of the situation, then we do not need 5-year professional schools in accounting. Our view is that users expect more of auditors and that the need to work in an increasingly complex environment will not decrease.²

² For example, see the recent report, Jeffrey Love, Sarbanes-Oxley: A Survey of Investor Opinion. AARP, Knowledge Management, Washington, DC, 2007

2.4.1.3.3 Consider whether accounting academics need to be encouraged to undertake a more 'practice-oriented' approach, including more practice-oriented research.

This question presumes that there is a schism in practice-based research and academic research. We simply disagree with the statement and submit that there has been considerable academic research, often cited by the PCAOB and the FASB, that have influenced their policies. In addition, the financial accounting section and the auditing section of the American Accounting Association have published syntheses of academic research³ as it pertains to accounting and auditing policy-making.⁴ Further, those syntheses of research often point out gaps in the logic of proposed policies, or the implications for judgment decisions where proper criteria for judgments have not been offered.

We would not disagree that the statement that a significant portion of academic research is seen as not practicable by many practitioners. However, we all must understand that there is a need to develop a body of research on which to fully discern answers to important issues. We have seen such research clarify and improve practice in such areas as:

- Fraud, and fraudulent financial reporting, including the consequences of earnings management on accounting quality and cost of capital,
- Statistical sampling (even if practice wants to ignore it),
- Measuring fair value of financial instruments, including the distinctions between debt and equity securities, as well as hybrid securities and derivatives,
- Improving the auditor's assessment of risk,
- Improving the consistency of internal control judgments,
- Improving the ability to predict going-concern problems with audited companies,
- Ascertaining the effect of improved disclosures in financial statements,
- Assessing the effect of audit attestation on the value of information.

There is an implication in the outline that there is such a thing as 'practice-oriented research' that is different from academic research. We would challenge your group to define the differences. In most cases, we see the two as highly interrelated. Further, we would also point out that there may be competitive advantages for the academic profession to perform the kind of research that we do because of our training, the discipline of subjecting all the research to peer review, the carefulness with which the research is being done, and the proper respect for the types of implications that can be made from the research. Indeed, the American Accounting Association publishes a journal (*Accounting Horizons*), the stated mission of which is to disseminate accounting research focused on professional and practice issues. That said, we believe some academics could expand their research to better address current accounting and

³ For example, see Roger Martin, Jay S. Rich, and T. Jeffrey Wilks, "Auditing Fair Value Measurements: A Synthesis of Relevant Research", *Accounting Horizons*, Vol. 20, No. 3, September 2006, pp. 287-303, or

⁴ See, for example, the recent comment letter submitted to the SEC Concept Release related to accepting IFRS without reconciliation: <http://www.sec.gov/comments/s7-13-07/s71307-91.pdf>

auditing issues such as improving our ability to make fair value judgments, or finding ways to simplify GAAP when there is not a significant difference between the simplified GAAP and more complex measurements.

2.4.2.1 *Shortage of Faculty PhDs*

This is an important issue. The American Accounting Association has written extensively on this issue⁵, the AICPA has had a task force looking at this issue, KPMG has a foundation that is working to diversify faculty backgrounds, and Robert Half⁶ have all addressed this issue. In our view, two proposals that we hear often contain serious flaws: (a) shorten the PhD program such that significant research is deemphasized in the program, or (b) populate more accounting programs with practitioner-oriented faculty – sometimes referred to as Clinical Faculty because of their backgrounds in the profession.

A Shortened PhD Program with Less Emphasis on Research

The fundamental flaw we see in such an approach is that it will marginalize accounting faculty in major research universities. Without an impactful research program, accounting faculty will not receive tenure and the accounting department will become viewed as a poor ‘stepchild’ within the business school. This will inevitably lead to significant decline in the schools that are most often listed in any poll of the top 20 accounting programs in the accounting. The profession depends on these schools to not only turn out top students, but to be ‘thought leaders’ for the profession and to carry out significant research. We also believe that other schools with less of a research emphasis still benefit from the exposure to research in doctoral programs and the ability to better analyze arguments for various accounting treatments or audit approaches.

An Increased Number of Clinical Faculty

We have benefitted from the use of clinical faculty, some on a part-time basis on some on a full-time basis, so we are not uniformly opposed to the idea. Some of the movement has been forced upon us because of the decrease in resources from state governments to support colleges and universities nationwide. Clinical faculty are often paid significantly less than tenure-track faculty and often teach because they love the profession and working with young people. Simply stated, this is not a sustainable way to build the foundation for the profession.

⁵ See R. David Plumlee, Steven J. Kachelmeier, Sylvia Madeo, Jamie H. Pratt, and George Krull, “Addressing the Shortage of Accounting Faculty”, *Issues in Accounting Education*, Vol. 21, No. 2, May 2006, pp 113-125, or the full study of the same topic on aaahq.org.

⁶ Robert Half, [Charting the Future of the Accounting, Finance, and Audit Professions](#), 2007. This is a report from a summit of leaders in the profession. The report calls for a greater partnership of the academic and practice professions to both attract younger people to the profession, and find ways to financially support accounting programs.

There are some significant drawbacks if the number of clinical faculty gets to a size where they are out of proportion to tenure-track faculty. Based on our experience, the drawbacks include:

- Loss of stature for the accounting program within the university,
- Less development of substantive research and thought leadership and less infusion of innovations in accounting thought in accounting curricula,
- Less program development, i.e. innovative approaches to education,
- Loss of accreditation by the AACSB,
- More teaching of accounting rules rather than accounting, audit, or tax concepts.

We believe all of these represent serious threats to the accounting profession and the development of young professionals to meet the practice demands described above.

Are There Easy Answers to the Shortage?

There are not many easy answers. We find that we are attracting 4- 5 excellent doctoral candidates each year that want a blend of strong academic training coupled with a faculty that are attuned to practice issues and have a commitment to quality teaching. The difficulty is to find sufficient financial support for the students as they complete the doctoral program. The program normally takes about 4 years to complete. The school has been working on fund raising to provide more support to doctoral candidates. The profession could certainly help here.

There are some things that the profession can do -- ranging from financial support of doctoral candidates, to financial support to keep key faculty at their institutions, to funding specific research or educational development projects, engaging faculty in joint research projects or case developments, or loaning key staff or partners to a university on a part-time basis to assist in the classroom.⁷ Collectively, these contributions can grow the resource pie so that accounting programs can continue to effectively address the education missions at the undergraduate, masters, and doctoral levels.

Sometimes we hear that “all universities want is more resources”. It would be disingenuous of us to not point out the importance of additional resources. We have to attract personnel into the profession who could be partners in public accounting firms, or CFO’s, but have a special talent in teaching and research. With major school salaries still less than ½ to 1/3 of CPA firm partners, and significantly less than many CFO’s, we must recognize these challenges and ensure a sufficient life style that will grow the next generation of faculty leaders.

⁷ As an aside, it is important to note that virtually every practitioner we have brought into the classroom has greatly underestimated the time that it takes when a faculty member is committed to keeping the class up to date, engaging students in meaningful, critical thinking projects, and emphasizing the conceptual basis for accounting decisions. That is not to say they do not do a good job, just that most do not realize the effort it takes to do a great job year after year.

2.4.2.2.5 Consider the benefits of, and how to balance, the class room education experience for students between theory and practical experience.

Our experience is that we have a robust internship program that gets students acquainted with practice. However, the value is limited unless we build off the internship experience in the graduate program. We do this in two ways. First, there is a unique three-week course that is required at the end of the spring internships. That class addresses significant issues that came up during a student's internship and promotes the sharing of experiences – good or bad, and requires students to discuss a significant accounting or auditing issue they addressed during the internship and how it was resolved. In addition, the course builds on both current issues and research to prepare the students for the graduate year. Second, the graduate courses also build on the internship whether we talk about accounting theory, tax, or audit.

The integration of the practice and classroom work comes only if there is a significant effort by the program and the professors to make such an integration happen. We do one other thing that we believe helps bring the two together. First, we limit the number of accounting courses in the graduate year to no more than half of the 30 credits required. Second, we meet with each student to better understand their industry or functional area interest that they may have developed in their internship. For example, if they see themselves working or auditing in the financial services sector, we have them take a series of courses in managing financial institutions (banks and insurance enterprises), corporate finance, advanced financial instruments, and risk and insurance. If they see themselves working with manufacturing clients, we have them take courses in supply chain management, production management, and similar topics. In other words, we try to force students to take more ownership of their career at an early point and then structure their course work to broaden their business, as well as accounting, knowledge.

We recognize that there are alternative approaches that are utilized very successfully by other universities, such as co-op programs, or new Masters' programs after some work experience. We simply report that our internship program was put together with significant thought and has been very successful in accomplishing our overall objective.

3.1 Consider the state licensing regime.

We are fully supportive of the committee's efforts to explore this area. Our students are clearly national students, and that is becoming more common across major universities.

Other Issues

The outline contains a number of issues where further research is needed, as well as areas where there exists a body of research. For example, there is quite a bit of research on fraud, earnings management and its consequences, expectations of investors, and audit approaches. There will continue to be need for fraud research as new and innovative ways to conduct fraud will continue to evolve as business changes. In our view, there is not enough attention paid to

the increasing role that dependence on information systems plays in an audit and in fraud detection.

There is some research on mandatory audit firm rotation. Some of that research indicates that new firms are less likely to detect material misstatements because of their lack of knowledge of the audit client and the industry. Thus, there may be a trade-off in obtaining greater skepticism from the new audit firm versus knowledge of the industry. We would also ask the members of your committee who sit on audit committees if they believe they put a high value on auditor skepticism when they are involved in a processing of evaluating changing outside auditors, or if other factors were dominant.

We suggest that there are some other issues that the committee might explore:

1. There is a discrepancy in services that can be provided by a firm registered with the PCAOB (doing public company audits), and those that are not registered with the PCAOB (private company audits). For example, consulting services that are prohibited for firms providing public audits are not prohibited by those doing non-public audits. We wonder about the inconsistency in the logic, as well as the economic effect, of having two different standards.
2. There is discussion of the greater movement to international standards without considering whether the movement increases the quality of information. However, there is little or no discussion to a similar movement in the U.S. to smaller-company GAAP and when and where a difference is merited. For example, if a smaller company engages in the same type of complex transactions as a larger company, why would the investor or banker be protected by different accounting measures or less disclosure?
3. There is little discussion on how large firms can increase consistent auditor judgments in a world where more judgment is required. We believe this is a substantial challenge for most audit firms.
4. How do we determine the right amount of discretion in financial reporting such that accounting reports are informative but not managed to achieve other objectives? This is central to the debates surround international accounting and auditing convergence and has important implication for auditing, as well as accounting standard setting.

We believe the Committee is addressing significant issues and would be pleased to provide further information on any of the topics addressed in this letter.

Sincerely,

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