ACCOUNTING PRACTICE ISSUES IN THE CLASSROOM: UNDERREPORTING TIME

Kelly F. Gamble, Valdosta State University

ABSTRACT

Recent accounting graduates should be better prepared to face practice dilemmas before entering the profession. Unfortunately, typical accounting programs fail to address common practice issues. I presented students with an original case in which they assumed the role of a new staff accountant who had exceeded the time budgets in two different scenarios. Students discussed how many of the extra hours they would report and explained their decisions. The students enjoyed the case and were actively engaged in the discussion. Some students expressed gratitude for giving them the assignment. The case met my goals of making students aware of an ethical dilemma they might face soon after graduating, and better preparing them to be successful as they enter the profession. Making young accountants aware of these dilemmas prior to graduation can help lower the occurrence of underreporting and provide a smoother transition into the profession.

Keywords: Accounting, Ethics, Hours, Time, Underreporting.

Case Materials: Available Upon Request

INTRODUCTION

Typical undergraduate and graduate accounting curricula place emphasis on technical knowledge in topic areas such as financial reporting standards and tax law. However, an important area of student development remains largely unaddressed. Though accounting students are exposed to a wealth of academic material, they may not be aware of some common ethical dilemmas facing accounting professionals until they encounter the problems on the job. The use of case studies in the classroom can help in this regard. While the students are not actually placed in a position that can affect their professional and/or financial lives, they can be introduced to situations in which they may be called upon to make these difficult decisions. Just having an awareness of these dilemmas before graduating can help them to be better prepared to make good decisions when they arise.

Further, the case study format encourages class discussion. Some students are hesitant to participate in class if they feel unprepared or lack confidence in their grasp of the material. Cases such as the one described below allow those students more opportunities to speak in class because the issues raised are not directly related to a textbook. Instead, they may find cases more engaging and be more willing to offer their opinions based on their personal beliefs. At the same time, students are able to practice their oral communication using technical language.

In this paper, I discuss the results of using a time reporting case in undergraduate and graduate accounting classes. I chose this scenario because students will likely encounter this situation very soon after joining accounting firms. It is an important issue that affects several areas of the firm’s practice. I elaborate on these points in the following sections. I then describe the case (materials included in the Appendix), along with class discussions and student comments.

Accountants who work in staff positions in public accounting firms are generally given time budgets along with their assigned jobs (I use the term '*accountant*' to refer to staff-level accountants in public accounting, regardless of practice area). Often, the amount of time budgeted for a job is based upon the time reported for the job in the previous year (Reffett et al., 2014). For new clients, budgets may be based on the work required for similar jobs. Reporting time is a fairly straight-forward matter when the accountant is able to complete the job within the specified time budget. However, in situations in which the time budget has been exceeded, the reporting of time becomes an ethical dilemma.

Ethical dilemmas can be described as problems for which an individual must make a decision when none of the options will result in a desirable outcome. They are extremely complicated issues which cannot be solved easily (CFI, 2020). New accountants are commonly faced with this situation (Pickerd et al., 2015). In the scenario discussed above, the accountant must decide between reporting honestly (which may result in a negative performance evaluation), or under-reporting the time spent on the job in an effort to appear more efficient. Research has shown that new accountants are often influenced by their immediate supervisors when making these decisions, thus the practice is often perpetuated (Pickerd et al., 2015).

These situations can become even more complex when firms offer staff bonuses or over-time pay based on the number of hours billed to clients during the year. In this instance, the accountant may be more inclined to report all of the time worked in an effort to receive higher pay. But the accountant must take several issues into account when deciding whether to underreport time (URT). These include the affect on co-workers via future time budgets (Hanlon, 1996), and/or violation of firm policy or personal beliefs (Ponemon, 1992).

Accounting Research, Education, and Practice

The research relevance and research productivity of accounting scholars has been out of sync with the accounting profession for decades. Only recently has the relevance of topics broadly studied by accounting researchers been examined through the lens of applicability to accounting practice (Pasewark, 2020). Moon & Wood (2020) discuss the wide gap between accounting research and the use of the results in practice. An important branch of accounting research, accounting education, has been widely under-investigated in the past. This is concerning because accounting education is the only research area that touches all of the accounting disciplines (Pasewark, 2020).

The education of accounting students is multifaceted. The students certainly need to gain a solid understand of subjects like financial reporting and tax law. But I propose that exposing them to '*real life*' accounting practice scenarios while they are in school will also help prepare them to enter the profession and may also reduce the frequency of undesirable behaviors. Many students complete internships before finishing their degree programs. However, because they are classified as interns, their time-reporting requirements may be limited or non-existent. Graduates may enter the profession without realizing that they will probably be confronted with scenarios like this on a regular basis. Their lack of preparedness can result in loss of firm revenue (Barrainkua & Espinosa-Pike, 2015), and/or higher rates of staff turnover for the firm (Mendoza, 2020).

One of the teaching areas that is most affected is that of business ethics. Sigurjonsson et al. (2015) state that, to date, the effort to teach students sound business ethics has failed. Elias (2006) writes:

"Shaping future accountants' ethical sensitivity at [the] early stage of their careers can have a positive impact on their future ethical choices" (p. 83)

Sigurjonsson et al. (2015) continued by claiming that the voices of accounting managers have gone largely unanswered in this area, and by discussing the lack of improvement in the ethics of graduating students. They call for a closer collaboration between industry and business schools (Sigurjonsson et al., 2015).

Use of Time Budgets in Accounting Firms

Public accounting firms typically generate revenue by charging clients an hourly rate for each professional assigned to a job. Accountants are required to track and report the time they spend working on each job to which they are assigned. As part of their control systems, accounting firms issue policies and procedures indicating that acts of intentional under- and/or over-reporting of time are considered policy violations. If caught, accountants engaging in such behaviors may be subject to disciplinary action or termination. However, research has shown that, most often, URT goes unpunished (Buchheit et al., 2009).

Time budgets help the managers and partners balance the workload for the staff accountants and also provide another performance measure by which the staff members can be evaluated. Those who consistently '*meet or beat*' the budgeted time for assigned jobs (i.e., complete jobs in fewer than the budgeted number of hours) are considered to be more efficient than those who routinely go over their time budgets (Agoglia et al., 2015). While proper preparation and use of time budgets can increase chargeable time through enhanced job control, they can create implicit pressure for accountants engage in URT (Lightner et al., 1983; Sweeney & Pierce, 2006). Less budget pressure results in lower incidents of URT (Agoglia et al., 2015; Svanberg & Öhman, 2013). However, research has demonstrated that explicit statements prohibiting URT do not address the incentives to engage in the behavior. Therefore, the practice continues to occur (Reffett et al., 2014).

When faced with a scenario in which he or she has "*blown*" a time budget, the accountant has three behavioral choices:

1. Perform the necessary work and record their actual time worked, facing potential consequences for being over-budget;
2. Perform the necessary work and '*eat*' some of the time (i.e., record only some of the hours worked and not get credit for the additional hours); or,
3. Not do all of the necessary work and assert that they did (Akers & Eaton, 2003).

Newly-hired staff accountants often receive two conflicting messages in these scenarios: (1) firm policies and external ethical standards stating that all time should be reported, and (2) accounting seniors and managers encouraging them to eat some of their time in order to make budget. Research has shown that the result of exposure to these conflicting messages is higher efficiency (i.e., more jobs come in at- or under-budget), but with an accompanying reduction in work accuracy (Martin et al., 2016). The act of URT has been considered to be a "*slippery slope*" in the realm of dysfunctional audit behaviors. This implies that once an accountant becomes comfortable with the practice, it is more likely that they will engage in more dysfunctional behavior later.

Extent of Underreporting

URT in public accounting is a fairly wide-spread practice within the accounting profession (Mendoza, 2020). It is the most common form of inaccurate time reporting (Smith et al., 1996). The issue was first formally addressed by the Commission on Auditors' Responsibilities in 1977. Smith & Hutton (1995) discussed the results of a survey of accountants in local, regional, and national American accounting firms. Results indicated that 55 percent of the respondents had underreported billable audit hours in response to time pressure (Smith & Hutton, 1995). A 1983 survey of 972 practicing accountants from three national accounting firms reported that 67 percent of respondents had underreported their billable time during the preceding year. The majority of these respondents had underreported between 1 and 9 percent of their time (Lightner et al., 1983).

Smith & Hutton (1995) surveyed 300 accountants in 13 cities across the United States. The authors found that 89 percent of respondents admitted that they had underreported their billable time during the prior year. Twenty-seven percent of respondents admitted that they had underreported 10 percent or more of their actual hours worked. This number includes 30 percent of partners and managers, 28 percent of seniors, and 22 percent of staff. In addition, 52 percent of respondents stated that they had underreported 5 percent or more of the hours they had worked in the most recent year (Smith et al., 1996). Another 41 percent said that they had underreported 10 or more hours in a single week. More recent studies indicate that the practice of underreporting is still prevalent at all levels of accounting firms of varying sizes (Agoglia et al., 2015; Taylor et al., 2012).

Reasons for Underreporting

According to Smith & Hutton (1995), accountants in public practice underreport their hours: when they exceed time budgets, when they feel that they are not being productive, or when they are unfamiliar with technical topics. Generally, individuals tended to blame themselves for their underreporting behavior. In addition, a majority of those responding to the Smith & Hutton (1995) survey said that they believed underreporting would likely lead to better performance evaluations, being seen as competent, increased job security, promotions, and better job assignments. They also believed that by underreporting, the firm would be able to bill all of their time to clients rather than writing-off excess hours, thus making the firm more profitable (Smith & Hutton, 1995).

Ponemon (1992) listed several other reasons for underreporting behavior. These include unattainable time budgets; explicit peer pressure; accountants' personally held beliefs and ethical values; client fee arrangements; accountants' positions within the firm; and stress (Ponemon, 1992). Other studies have identified several other reasons, including: negative impact on reputation (Doby & Caplan, 1995); being assigned to more desirable clients (Agoglia et al., 2015); and receiving better performance reviews (Lightner et al., 1983; McNair, 1991).

Effects of Bonuses and Over-Time Pay

Further complicating the matter, some accounting firms use the total number of billable hours reported by its staff members as a performance measure (Mendoza, 2020). In such firms, employees are often given a target number of billable hours for the fiscal year. If the target is met or exceeded, the accountant is then entitled to a bonus or over-time pay based on the number of hours billed in excess of the target. In such an environment, the accountant may be tempted to overreport billable hours, essentially lying in an effort to receive a higher bonus. The competing objectives of earning a bonus (i.e., maximizing total billable hours reported) while working within time budgets (i.e., minimizing the number of hours worked per job) can create pressure for accountants to either over- or under-report their billable hours (Heath et al., 1999).

While the decision to overreport is likely to be based solely on short-term financial gain (outside the scope of this paper), the incentives for underreporting behavior are more complex. For example, if the firm offers a bonus based on billable hours, then auditors who choose to underreport time are taking money out of their own pockets. On the other hand, if the auditor tends to work over-budget and fears a bad evaluation, he or she may choose to reduce or forgo the annual bonus and not report all of the hours worked.

Impact on the Firm

At first glance, underreporting billable hours may not seem to affect anyone except the accountant who decides to engage in the practice. However, these individual decisions can potentially have a significant negative impact on the firm. Underreporting affects many of the accounting firm's internal decision-making processes including client billing, cost control, future budget preparation, personnel evaluation, staff scheduling and determination of audit quality (Lightner et al., 1983; Otley & Pierce, 1996; Reffett et al., 2014; Mendoza, 2020), If all billable hours are not reported, then clients may not be charged for legitimate time spent completing their work. As a result, fees and time proposed for future work may be too low, leading to lost revenues and a perpetuation of the budgeting problem (Lightner et al., 1983). Additionally, the firm incurs opportunity costs for the time it is unable to bill to clients (Smith et al., 1996).

McNair (1991) examined the unique dilemma faced by accounting firms through an exploratory field study. By performing a series of interviews, he concluded that public accounting firms operate in an atmosphere of conflict. Inherent in what he calls the '*business of auditing*' (defined as an auditor's ability to maximize the profitability of an individual audit) is the trade-off between cost and quality. Firms tend to address this conflict by embedding the problem into time budgets (McNair, 1991).

The author stated that time budgets are the primary control tool used by management to evaluate the performance of staff- and senior-level accountants. Since effort is unobservable, many senior and staff auditors are evaluated by their realization rates and/or their ability to meet time budgets. In an attempt to increase realization rates, management may impose very tight time budgets on lower-level auditors. Even with tighter budgets, high quality work is expected. According to McNair, junior auditors resolve the cost/quality conflict by working enough hours to produce a high-quality audit, but then underreport their time. They adopt this behavior to succeed in the business of auditing (McNair, 1991).

McNair (1991) also described time budgets as a reflection of the conflicting goals faced by the accounting firm. He referred to the 'double-bind' created by accounting firms. This refers to a situation in which individuals are immobilized from constructive action and are simultaneously prevented from correcting the situation. The double-bind is created by organizations as a defensive routine, an institutionalized, long-term, mixed message about which discussion is forbidden (Swenson, 2005).

Essentially, these accountants are faced with a lose-lose situation. Pressures of the control process force them to make decisions that are prohibited by the system. The result is an environment of sociological ambivalence in which the individual is pulled in psychologically opposite directions (McNair, 1991). Some argue that such ambivalence is functional for the firm, allowing it to remain competitive and profitable. However, in this case, what is good for the firm may not be good for the individual (Jansen & VonGlinow, 1985).

The environment described above is one that works against the employees that firms should be trying to retain (Buchheit et al., 2009). These firms reward upper-level accountants for exerting implicit pressure on juniors to underreport. At the same time, the system rewards those juniors who are most willing to underreport. This is particularly true when the lower-level accountants' compensation includes an overtime bonus or overtime pay (Buchheit et al., 2009). Once the practice of underreporting begins, individuals are hard-pressed to '*keep up appearances*,' and many leave the profession suffering from burnout (Smith et al., 1996). When combined with the above discussion on the extent of underreporting and its impact on the firm, this evidence indicates that the financial effects of underreporting can be substantial and wide-spread across accounting firms of all sizes. While the practice continues (Meador, 2014; Ramos, 2017), research has recently become focused on ways to mitigate URT behavior (Reffett et al., 2014; Weber & Stefaniak, 2018).

Firms have been struggling with employee turnover for many years. As employees leave, the firm incurs additional costs to recruit and train replacements. A study performed by the University of Southern California (USC) indicates that this problem may be particularly significant at the senior level (USC, 2004). Pricewaterhouse Coopers (PwC), one of the '*Big 4*' accounting firms, requested that USC perform this study in an effort to determine why employees choose to leave the firm. One of the firm's primary concerns was that it had lost many employees who could have been effective managers while they were at the staff or senior levels. The study indicated that job satisfaction was the key to retaining employees. Of all employment levels, senior associates were least satisfied with their jobs and with their pay. Tight time budgets were often cited as a cause of job dissatisfaction. One of the conclusions drawn from the USC study was that retaining senior associates would require attention to the way their jobs are structured, work demands, and pay satisfaction (USC, 2004).

CONCLUSION

My students really enjoyed working this case. I have assigned the case as both a written project as well as for class discussion. I've used it with both undergraduate and graduate students. Students in both groups were both able to learn something from the assignment.

The undergraduate students had not yet completed accounting internships when they worked the case. The concept of logging time was new to them. Part of their discussion included how difficult must be to record time so precisely. Some were unfamiliar with the difference between public and private accounting. This allowed for additional discussion and the students were very eager to both ask, and answer, questions. By comparison, many of the graduate students had already completed at least one internship at an accounting firm. They were able to share their stories and experiences with the other students, lending more validity to the case scenarios. One student thanked me for giving them the case because, in the student's words, '*nobody ever tells us this stuff*.'

With regard to the case itself, both graduate and undergraduate students were able to discern that the cause of the time overage was the accountant in one scenario and the client in the other. I received interesting responses when I asked whether the bonus pay was important when making their decisions. Most of the students answered in the negative. Many of the students were able to identify the ethical dilemmas included in the case. One student remarked that if someone was motivated primarily by the prospect of a larger bonus, then they are in the wrong business.

Overall, the case met my objectives. Students were engaged and interested in the topics. They eagerly interacted with each other as they shared stories and experiences. And several of them were introduced to a previously unknown, but important, part of accounting practice. Of course, discussing a fictional case is not the same as solving ethical dilemmas in real life. But just being made aware of such issues before they complete their degree programs will better prepare them for their transition into the world of professional accounting. Future work should examine other common ethical dilemmas and the ways in which professional commitment can be enhanced during the educational process.

REFERENCES

Agoglia, C., Hatfield, R., & Lambert, T. (2015). Audit Team Time Reporting: An Agency Theory Perspective. *Accounting, Organizations and Society*, *44*, 1–14.

Akers, M.D., & Eaton, T.V. (2003). Underreporting of Chargeable Time: The Impact of Gender and Characteristics of Underreporters. *Journal of Managerial Issues, XV*(1), 82-96.

Barrainkua, I., & Espinosa-Pike, M. (2015). New Insights into Underreporting of Time: The Audit Partner Context. *Accounting, Auditing, and Accountability Journal*, *28*(4), 495–514.

Buchheit, S., Pasewark, W.R., & Strawser, J.R. (2009). A Comparison of Auditor and Non-auditor Performance Evaluations: Are Accountants Harsh cCitics? *Managerial Auditing Journal*, *24*(1), 22-38. https://doi.org/10.1108/02686900910919884

California (USC), U. of S. (2004). *The Value of the PwC professional experience: What Employees Gain by Staying longer at the firm, and why they leave*.

CFI. (2020). *What is an Ethical Dilemma?* Corporate Finance Institute. www.corporatefinanceinstitute.com/resources/knowledge/other.ethical-dilemma

Doby, V.J., & Caplan, R.D. (1995). Organizational stress as threat to reputation: Effects on anxiety at work and home. *Academy of Management Journal*, *38*(4), 1105-1123.

Hanlon, G. (1996). Casino Capitalism and the Rise of the Commercialised Service Class -- an Examination of the Accountant. *Critical Perspectives in Accounting*, *7*(2), 411-444.

Heath, C., Larrick, R.P., & Wu, G. (1999). Goals as Reference Points. In *Cognitive Psychology* (Vol. 38). http://www.idealibrary.comon

Jansen, E., & VonGlinow, M. (1985). Ethical Ambivalence and Organizational Reward Systems. *Academy of Management Review*, *10*(4).

Lightner, S.M., Leisenring, J.J., & Winters, A.J. (1983). Underreporting Chargeable Time. *Journal of Accountancy*, *155*, 52-57.

Martin, R., Stammerjohan, W., & Drake, A. (2016). The Effects of Conflicting Messages on Audit Accuracy and Efficiency. *Academy of Accounting and Finance Studies Journal*, *20(2)*,23-41.

McNair, C.J. (1991). Proper Compromises: the Management Control Dilemma in Public Accounting and its Impact on Auditor Behavior. *Accounting, Organizations and Society*, *16*(7), 635-653.

Meador, B. (2014). Learn How and Why Accounting Staff Eat Time & How to Fix the Problem. *Advice for Tax Preparers.* https://www.advicefortaxpreparers.com/eating-time/.

Mendoza, K.I. (2020). Reducing Underreporting by Aggregating Budgeted Time. *The Accounting Review*, *95*(5), 299–319. https://doi.org/10.2308/accr-52624/2445862/10.2308_accr-52624.pdf

Moon, J.S., & Wood, D.A. (2020). Research Initiatives in Accounting Education: Research Relevance and Research Productivity. *Issues in Accounting Education*, *35(4)*, 111-122.

Otley, D.T., & Pierce, B.J. (1996). Auditor time budget pressure: consequences and antecedents. *Auditing & Accountability Journal; Bradford*, *9*(1), 31-58.

Pasewark, W.R. (2020). Research Initiatives in Accounting Education: A Proposed Agenda for Accounting Education Research. *Issues in Accounting Education, 35(4)*, 3-7.

Pickerd, J.S., Summers, S.L., & Wood, D.A. (2015). An Examination of How Entry-Level Staff Auditors Respond to Tone at the Top vis-a-vis Tone at the Bottom. *Behavioral Research in Accounting*, *27*(1), 79-98.

Ponemon, L.A. (1992). Auditor Underreporting of Time and Moral Reasoning: An experimental lab study. In *Contemporary Accounting Research; Fall* (Vol. 9).

Ramos, J. (2017). Stop Eating Your Time. *The Daily CPA*, https://thedailycpa.com/stop-eating-time/

Reffett, A., Eaton, T.V, & Gannod, G. (2014). An Experimental Examination of Underreporting of Time. In *Journal of Managerial Issues*, *26*(2).

Sigurjonsson, T.F., Arnardotir, A.A.,Vaiman, V., & Rikhardsson, P. (2015). Managers' Views on Ethics Education in Business Schools: An Empirical Study. *Journal of Business Ethics, 130*, 1-13.

Smith, W.R., & Hutton, M. (1995). Underreporting Time: An Analysis of Current Tax Practice. *Journal of Applied Business Research*, *11*(1), 39-45.

Smith, W.R., Hutton, M., & Jordan, C. (1996). Underreporting time: Accountants are doing it more and enjoying it less. *The CPA Journal*, *66*(10), 67.

Svanberg, J., & Öhman, P. (2013). Auditors’ Time Pressure: Does Ethical Culture Support Audit Quality? *Managerial Auditing Journal*, *28*(7), 572–591. https://doi.org/10.1108/MAJ-10-2012-0761

Sweeney, B., & Pierce, B. (2006). Good Hours, Bad Hours and Auditors’ Defence Mechanisms in Audit Firms. *Accounting, Auditing and Accountability Journal*, *19*(6), 858–892. https://doi.org/10.1108/09513570610709908

Swenson, D. (2005). *Defensive Routines: The Double-Bind*. http://faculty.css.edu/dswenson/web/6300-OBOD/defroutines.htm

Taylor, E.Z., Curtis, M.B., & Chui, L. (2012). Staff Auditors’ Observations of Questionable Peer Behavior The View from the Other Side. *The CPA Journal*, *66*.

Weber, J., & Stefaniak, C.M. (2018). Using Undisclosed Time Budgets to Reduce the Magnitude of Auditors' Underreporting of Chargeable Time. *Behavioral Research in Accounting, 30(2),* 95-108.