



Study on the Influence of CPAs' Individual Characteristics on Integrity Conduct

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Abstract

By constructing a behaviour selection model, the paper relies on the method of Net Logo simulation for simulation experiments. We study the influence of CPA's individual characteristics on integrity conduct from three aspects of independence, industry specialization and tenure. The results of the study found that independence, industry specialization and tenure will have an impact on the integrity conduct. Besides, with the improvement of independence, industry specialization and tenure, their integrity conduct presents an inverted U type.

Keywords: CPA; Individual characteristics; Independence; Industry specialization; Tenure.

1. Introduction

As we know, there are more and more certified public accountants (CPA) and listed corporation provide false accounting information together in the securities market. People want to know what happened to these certified public accountants [1]. In life, some units under auditing bribe these certified public accountants with lot of benefits in order to obtain personal interests and hope that these certified public accountants can cooperate with them. At present, audit fees in China are low. The normal income of Certified Public Accountants is far lower than the bribe. If certified public accountants help to pad the bill, they can get more benefits than to be honestly. So, some certified public accountants choose not to be honest. This kind of behavior not only damaged the image of the certified public accountant as "economic police", but also has an impact on the market economy. Pan Xu-lun had put forward the importance of good faith for the accounting personnel in a long time ago [2]. Honesty is responsibility for certified public accountants. In 2003, the CPA industry has launched an activity to enhance honesty culture construction. The purpose is to foster and develop the integrity of the certified public accountant industry, reestablish the integrity image of the entire industry [3]. In June 27, 2014, the State Council issued and implemented the "social credit system construction plan (2014 - 2020)". The plan pointed out that the qualification exam, professional evaluation, annual appraisal and evaluation of professional titles of accountants, tax accountants, lawyers and other occupational population should strengthen the honesty education to help them establish correct occupational values. Besides, the plan decides to establish credit archives and exercise a veto with only one vote on serious dishonesty behavior [4]. In 2014, 2300 certified public accountants in Guangzhou signed honesty convention. They promised to consciously resist the requirements that customers hope them to pad the bill [5]. The problem of the integrity of certified public accountants has become the focus of the society.

Defond and Francis believe that the individual level of accounting firms should be an important factor in the study of audit quality [6]. However, at present, the focus of domestic and foreign research is mainly on the firm level and neglect the influence of the individual level [7]. For example, Yuan Yuan and Liu Jun studied the impact of the audit independence on the quality of accounting information [8]. Liu Wen-Jun, Mi Li and Fu Liang-Xuan researched the relationship between audit industry expertise and audit quality [9]. In fact, Signature certified public

accountants develop the audit plan, control audit implementation, determine audit opinion and check audit quality. Therefore, the individual characteristics of the certified public accountants are very important to the audit quality. According to the research of De Angelo, the audit quality is determined by the joint probability of finding and reporting irregularities by certified public accountants in the financial statements [10]. The probability of finding irregularities mainly depends on the professional skills of the certified public accountants. The problem whether the certified public accountants report irregularities means whether they will choose the honesty behavior. So far, the research of audit quality is mainly based on the level of audit quality to judge whether the certified public accountant is honest. This is more biased in favor of the surface integrity. Fine & Holyfield thought that people's trust in a person is not only dependent on the perception of credibility, but also on the identity of the person, the rules of the organization, and the reflection of intuition and emotion [11]. Therefore, the surface of the trust does not mean that certified public accountants will not pad the bill. Especially for certified public accountants, although the professional nature require that they must be honest, but the dependence of certified public accountants to the business of the listing Corporation makes it difficult to be completely honest. When the units under auditing require them to pad the bill, the certified public accountants will face the choice of individual economic interests and social public interests. Therefore, this paper will focus on the study of the effect of the individual characteristics of the certified public accountants on the integrity of the certified public accountants when the units under auditing require them to pad the bill. In addition, because of the research of this paper is a deliberate deception, it is difficult to get real data through interviews. Therefore, this paper will use the analog simulation to test the influence of the individual characteristics of the certified public accountant to their integrity conduct.

2. Individual Characteristics of Certified Public Accountant

The certified public accountant is a professional who has obtained the certificate of certified public accountant in accordance with the law and accepts the practice of the audit, accounting consultancy and accounting services business. The staff of the certified public accountants have their own individual characteristics. Therefore, this paper made a lot of literature review in May 2014. The paper used titles as "accounting sincerity" to search in EBSCO and CNKI and found 3262 articles. Then, we used titles as "the accounting sincerity of the certified public accountant" to search and found 75 articles. At last, we added the keyword "effect", leaving only 4 articles. There's few direct research on the factors of the certified public accountants' integrity conduct. Most of the scholars use the audit quality to determine whether the certified public accountants is honest or not. So we used the "audit quality" as the keyword to search, collecting 20947 articles. Then, we added the keyword "impact factor", remaining 133 articles. After that, we compared the articles and summarized the following characteristics (n represents the number of articles).

Independence (n=7)	Industry Expertise (n=8)
Mautz & Sharaf, 1961 Brink & Witt, 1982 Abbott, Parker & Park, 2000 Beasley & Salterio, 2001 Chen Han-wen & Huang Zong-lan, 2001 Bédard, J., S. M. Chtourou & L. Courteau, 2004 Tian Guang-da, 2010	O.Keefe, T.B., R.D.King & K.M.Gaver, 1994 Solomon, I., M. D. Shields, & O. R. Whittington, 1999 Carcello & Nagy, 2004 Xia Li-jun, 2004 Cai Chun & Xian Wen-duo, 2007 Lim & Tan, 2008 Liu Gui-liang & Mou Qian, 2008 Mi Li & Fu Liang-xuan, 2010
Tenure (n=8)	Gender (n=4)
De Angelo, 1981 Watts & Zimmerman, 1983 Myers & Omer, 2003 Yu Yu-miao & Li Lin, 2006 Chen Xin-yuan & Xia Li-jun, 2006 Liu Qi-liang, 2006 Dan Dhaliwal & Vic Naiker&Farshid Navissi, 2010 Zhou Wei, Xu Yu-de & Wang Ning, 2012	Ding Li, Li Ming-hui & Lv Wei, 2012 Liu Xiao-chun, 2014 Luo Chun-hua, Tang Jian-xin & Wang Yu-sheng, 2014 Wang Liang-chen, Dong Lin, Yang Da-li & Sun Fei, 2014
Position (n=1)	Other Qualifications (n=1)
Luo Chun-hua, Tang Jian-xin & Wang Yu-sheng, 2014	Liu Xiao-chun, 2014

2.1 Independence

Independence is the foundation of audit profession. The nature of the certified public accountants decides that they should have a high independence. They can audit and publish audit opinion with objective, fair and realistic attitude [12]. However, the economic dependence and independence of certified public accountants is opposite. The economic interests tend of certified public accountants will weak his independence and influence his professional judgment. On the contrary, the certified public accountants with independence will have little economic agent to collude with the senior management so that they can monitor the performance of the manager objectively and fairly. Therefore, the improvement of the independence of the certified public accountants will make them choose integrity conduct. Previous studies have shown that there is a positive correlation between the independence and the quality of the financial statements [13-16]. However, it should be pointed out that the independence is a dynamic process, not a static one. Brink & Witt have suggested that independence is a relative concept, sometimes strong and sometimes weak [17]. To a certain extent, the auditor's independence depends on the game between the auditor and the audit client. The equilibrium points of the two sides determine the independence [18].

2.2 Industry Expertise

Auditor industry specialization is an important factor that affects the audit quality, which is the knowledge and expertise owned by the auditor [19]. Scholars at home and abroad have different opinions on whether the impact of industry expertise is positive or negative. O.Keefe et al. believes that the audit staff with industry expertise have lower possibility to violate the GAAP's reporting guidelines [20]. Because the audit staff with industry expertise have more professional knowledge so as to make accurate audit judgment [21]. Carcello & Nagy also proposed that the audit staff's industry expertise and the frequency of financial fraud have negative correlation [22]. In addition, Lim & Tan found that auditors' industry expertise makes it more likely to issue continuous business non - standard opinions and reduce the possibility of financial restatement [23]. In the domestic research, Cai Chun & Xian Wendo found that the accounting firm industry expertise and audit quality have negative correlation through the analysis of the audit market of China listing Corporation [24]. Liu Gui-liang & Mou Qian's research also shows that the auditor's industry expertise does not have a role in improving audit quality [25]. While Liu Wen-Jun, Mi Li & Fu Liang-xuan found that the auditor's industry expertise can improve audit quality through the analysis of the companies' empirical evidence of financial fraud. They also found that the cause of the differences is in the selection of measures of the auditor's industry expertise [9]. This study considers the certified public accountants' industry expertise can make them choose integrity conduct to some extent. Because if certified public accountants have industry expertise, the knowledge and expertise in a particular industry can make them know the customer's business situation better and more likely to find out the potential Vital mistakes in financial report compared to those with no industry expertise and ultimately choose integrity conduct.

2.3 Tenure

The "Sarbanes - Oxley " bill requires that the companies should implement audit partner rotation system what lead to a dispute about whether audit tenure will have a positive impact on audit quality. At present, there are two views on the relationship between tenure and audit quality. One view is that there's a negative correlation between audit tenure and audit quality. Bhagat & Black [27] Vafeas [28] found that if the certified public accountants' tenure is short, they will be less affected by the client company and will have more positive impact on the audit quality. Liu Qi-liang found that audit tenure and audit quality is negatively related through the study of listing corporation from 1998 to 2004 [29]. Zhou Wei et al. found that when the accounting firm has little money, the extension of the term of the certified public accountants will lead to a significant reduction in the robustness of the accounting report, while when the accounting firm has much money, the relationship between tenure and the stability of the accounting earnings is not clear [30]. The extension of audit tenure has a negative impact on audit quality since the longer the auditor's tenure is, the more likely they will have "economic dependence" on the client company. If the certified public accountants choose not to connive with the audited units, then they are likely to be faced with the danger of being fired. This will cut off their source of the economy which leads them to choose to pad the bill [31-32]. Another view is that long tenure will not affect audit quality. In the report by Price Waterhouse Coopers in 2002, when the certified public accountants' tenure is short, they cannot know the client's information well, then the audit may fail. Myers & Omer found that audit quality and audit tenure is positively related through the study of the listing corporation in America from 1998 to 2000 [33]. The reason of this phenomenon is that when the auditor's tenure is long, the number of audit is also increased, so that the audit staff can know the characteristics of the production and operation, the transaction process, operating system and internal control system of the company well. Hence, the audit quality can be improved [34]. In addition, Chen Xin-yuan & Xia Li-jun came to a different view of the previous scholars. They thought that the audit tenure and audit quality are inverted U type relationship. When the audit tenure is less than a certain year (about 6 years), the increase of audit tenure has a positive effect on audit quality. While when the audit tenure is over a certain year (about 6 years), the increase of audit tenure has a

negative effect on audit quality. However, scholars generally believe that longer audit tenure will damage the auditor's independence, but it can improve the professional skills of audit staff [35].

2.4 Principle of the Certified Public Accountants' Behavior Choice

2.4.1 Expected Revenue

People are rational economic man, and the certified public accountants are no exception. Adams Smith have pointed out that "self-interest" is the nature of "economic person" in The Wealth of Nations [36]. At the same time, the behavior of the certified public accountant is regulated by the government, the association of certified public accountants and other departments. When a certified public accountant is found to pad the bill, he will be punished. Thus, the expected revenue of Certified Public Accountants is expressed as follows:

When the certified public accountant is honest, the revenue is:

$$U = R \tag{1}$$

When the certified public accountant is not honest, the expected revenue is:

$$U_n = (1 - q) * (R_c + R) + q * (Rc + R - C_1 - C_2) \tag{2}$$

In addition, $R_c = \varepsilon * R$

Symbol Description:

R : The income obtained by the certified public accountant under normal circumstances, including the wages, benefits, etc.

Rc : Abnormal returns obtained by certified public accountant when he is dishonest.

C1 : The government departments fine the certified public accountant when he is dishonest.

C2 : When the certified public accountant' dishonest behavior is found, he should pay social costs, including demotion, dismissal, moral pressure, social public opinion pressure etc.

E : When the certified public accountant pads the bill, his income can increase ε times.

Q : The ratio of spot check conducted by the supervision department.

2.4.2 Behavior Probability Model

Since this study research on the probability of the certified public accountant choosing the dishonest behavior under the generally expected return when dishonest. In the behavior probability model, the input is the expected return of the behavior, and the output is the probability of choosing the related behavior. In the paper, the certified public accountant 's behavior is simplified into honest behavior and dishonest behavior, that is a_+ and a_- . The behavior probability model is constructed as follows:

$$\left\{ \begin{aligned} P_i(a_+) &= \frac{e^{\{\beta_{i0} + (\beta_{i1} + \beta_{i2} + \beta_{i3})u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)\}}}{1 + e^{\{\beta_{i0} + (\beta_{i1} + \beta_{i2} + \beta_{i3})u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)\}}} \\ P_i(a_-) &= 1 - P_i(a_+) \\ &= 1 - \frac{e^{\{\beta_{i0} + (\beta_{i1} + \beta_{i2} + \beta_{i3})u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)\}}}{1 + e^{\{\beta_{i0} + (\beta_{i1} + \beta_{i2} + \beta_{i3})u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)\}}} \\ &= \frac{1}{1 + e^{\{\beta_{i0} + (\beta_{i1} + \beta_{i2} + \beta_{i3})u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)\}}} \\ \frac{P_i(a_+)}{P_i(a_-)} &= e^{\{\beta_{i0} + \beta_{i1} + \beta_{i2} + \beta_{i3}\}u_i(a_+) - (\beta_{i4} + \beta_{i5} + \beta_{i6})u_i(a_-)} \end{aligned} \right.$$

In this model, β_{ij} is the regression coefficient, and the value range is $\beta_{i0} \in (-\infty, \infty)$; When $i \in [1, 2, \dots, N]$; When $i \in [1, 2, \dots, N]$, $j \in [1, 2, \dots, 6]$, $\beta_{ij} > 0$.

3. Model Initialization

3.1 Setting of Environment Parameter

Table 1: Setting of Environment Parameter	
Model Parameter	Parameter Values
Range of Analog interface	20×20
Total number of subjects	100
Number of Certified Public Accountants in good faith	90
Number of Certified Public Accountants in bad faith	10
Color of Certified Public Accountants in good faith	White
Color of Certified Public Accountants in bad faith	Black

3.2 Expected Revenue of Certified Public Accountants

Table 2: Setting of Expected Revenue Parameter					
R	Rc	C1	C2	ε	q
[8,10]	$\varepsilon * R$	6	4*R	6- β_1	0.40

3.3 Subject Characteristics of Certified Public Accountants

The degree of independence of certified public accountants is expressed by β_{i1} and the range is [0, 6]. Among them, 0 said that the certified public accountant does not have independence, while the 6 is the strongest. Similarly, the certified public accountants' industry expertise and tenure is expressed by β_{i2} and β_{i3} and the range is [0, 6]. β_{i1} , β_{i2} and β_{i3} are the coefficient of the expected revenue of the certified public accountant when they are honest. β_{i4} , β_{i5} and β_{i6} are the coefficient of the expected revenue of the certified public accountant when they are dishonest. At the same time, they meet the following relationship:

$$\begin{cases} \beta_{i1} + \beta_{i4} = 6 \\ \beta_{i2} + \beta_{i5} = 6 \\ \beta_{i3} + \beta_{i6} = 6 \end{cases}$$

The initial parameters are set as follows :

Table 3: Initial Parameter Settings			
β_{i0}	β_{i1}	β_{i2}	β_{i3}
2	2	3	2

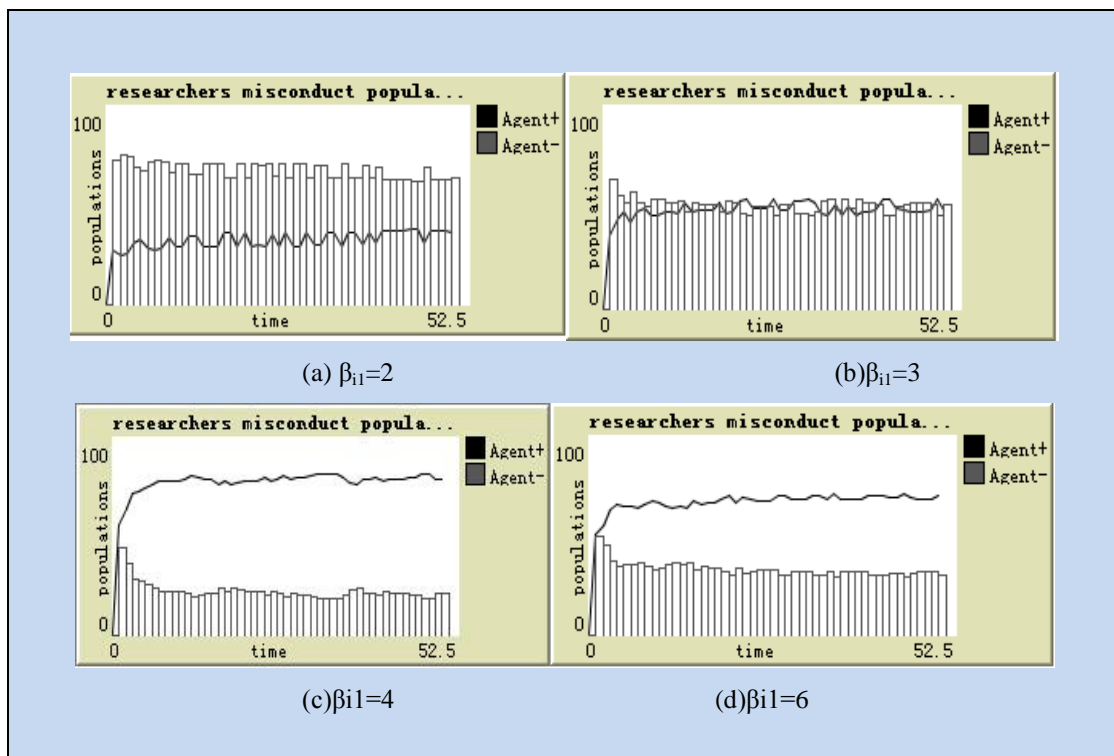
4. Analysis of the Simulation Results

After initialization, the system begins to run. In this study, the effects of independence, industry expertise and tenure on the integrity conduct of certified public accountants are simulated.

4.1. Analysis of the Simulation Results of the Independence and Integrity Conduct of Certified Public Accountants

Through the experiment, we found that when the value of β_{i1} is 2, 3, 4, 6, the comparison between these graphs is more obvious. The dark lines in the picture indicate the number of certified public accountants who choose honest behavior, and the light colored lines are the number of certified public accountants in the choice of dishonest behavior. Independence is considered to be the soul of audit, is the premise of ensuring the integrity of the certified public accountants. Defond Wong & Shuhua Li considered that as long as there is potential factors can lead to the loss of independence, we should say the audit quality cannot be guaranteed and the audit opinion should be considered to be questionable. From figure 1a-c, we can see that with the increase of the independence, more and more certified public accountants choose integrity conduct. This also confirms the influence of independence on the certified public accountants. However, with the degree of independence becoming higher, we find that the number of the certified public accountants who choose integrity conduct come to decrease from figure 1a-d. We believe that this phenomenon is due to the certified public accountants are also economic persons. At the same time, the economic man is rational person who wants to maximization their own interests. When the degree of independence is higher and higher, due to the unique nature of the certified public accountants, their job content is transparent to the company's shareholders or other certified public accountants. At this time, when the auditing company requires the certified public accountant to cooperate with them, the certified public accountants may choose dishonest behavior out of the great interests.

Figure 1: The Simulation Results of the Effect of Changing the Degree of Independence on the Behavior Choice

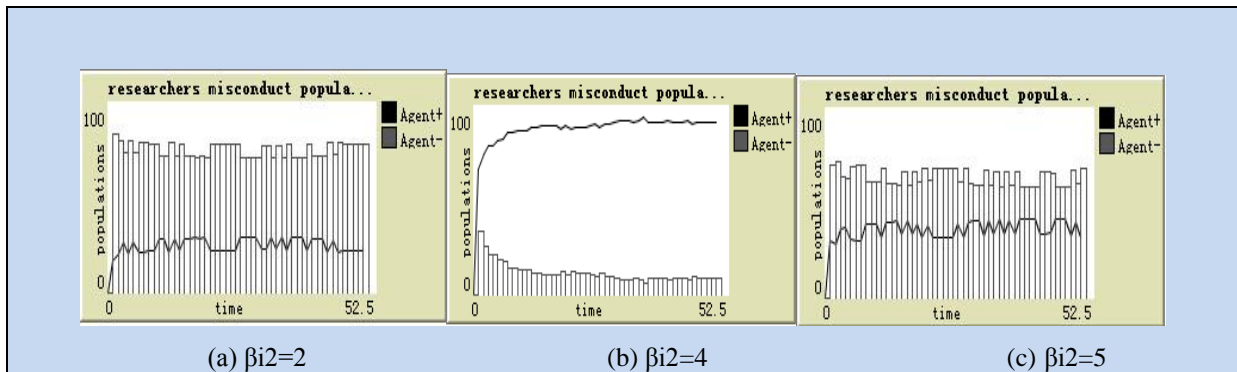


4.2. Analysis of the Simulation Results of the Industry Expertise and Integrity Conduct of Certified Public Accountants

Certified public accountants with industry expertise can improve their professional competence and know the business mode of specific industries and the source of the risk of errors in-depth which is more conducive to develop knowledge and audit methods of specific industry [37]. As a result, we think that certified public accountants with industry expertise can be more in-depth understanding and make accurate judgment of the financial statements of the Auditing Company. Besides, these advantages also make the quality of audit reports to be improved. However, domestic and foreign scholars have different research results. Foreign scholars generally believe that the industry expertise can be a good way to improve the certified public accountants' audit ability and

audit quality, while domestic scholars' research results are very different. Most domestic scholars believe that the certified public accountants' industry expertise and audit quality is not relevant or even negative. From figure 2a-c, we can see that in a certain range, with the improvement of the certified public accountants' industry expertise, the probability of choosing honest behavior is also improved. But in figure 2c, the improvement of the degree of industry expertise has reduced the integrity conduct of the certified public accountants. We believe that the reason for this is that the improvement of industry expertise is a double-edged sword. On the one hand, the improvement of the industry expertise can improve the quality of the audit report. On the other hand, with the improvement of industry expertise, the certified public accountants is getting better and better understanding of this industry, and clearly know where are the loopholes what makes it easier to publish false audit information.

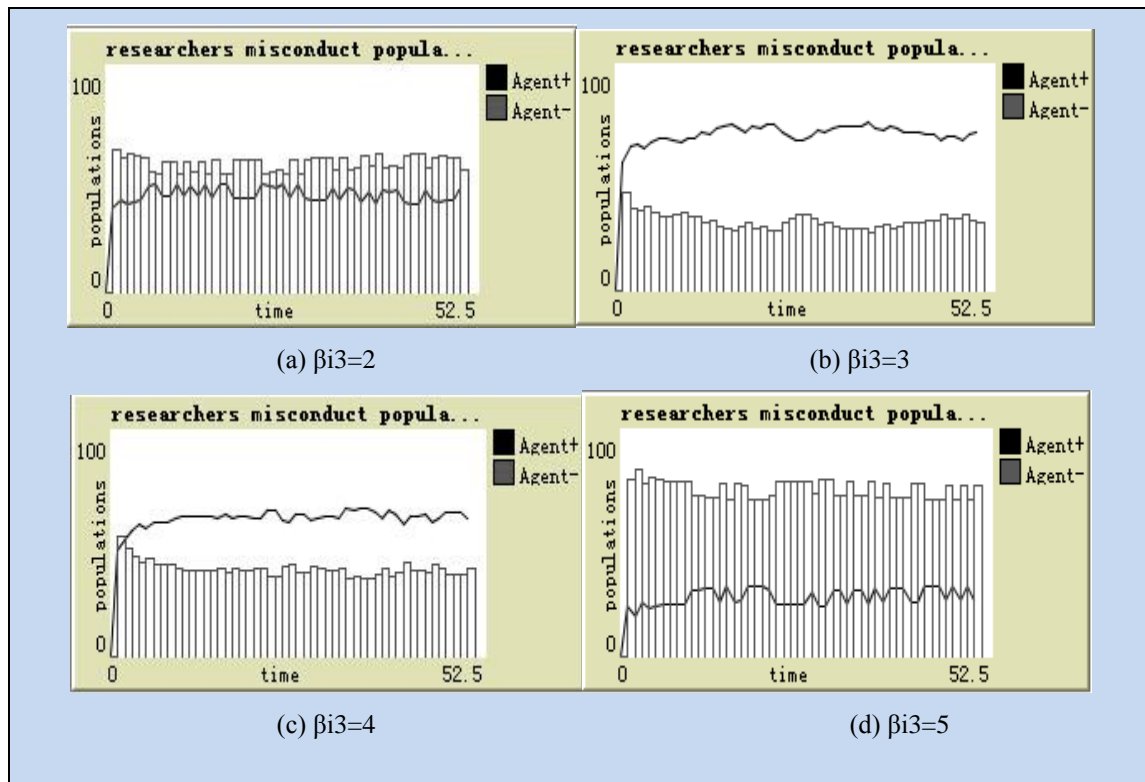
Figure 2: The Simulation Results of the Effect Of Changing the Degree Of Industry Expertise on the Behavior Choice



4.3. Analysis of the Simulation Results of the Tenure and Integrity Conduct of Certified Public Accountants

Zhou Dong-Hua et al. found that investors reject the listing companies with long tenure and standard audit opinion [26]. From figure 4a-d we can see that when the certified public accountants' tenure becomes longer and longer, the number of integrity behavior of the certified public accountants is accompanied by a rise, but to a certain period of time, it come to decline. This study argues that this is because at the beginning of, certified public accountants do not understand clients' situation, so padding the bill is not controllable. With the extension of the certified public accountants' tenure and the increasing number of audits, certified public accountants get more understanding of clients so that they can take effective audit procedures to help clients pad the bill. At the same time, with the increase of tenure, the emotional connection between the certified public accountants and clients continues to deepen. On the one hand, this will reduce their professional attitude. On the other hand, this will increase their dependence on the clients, so as to cause the CPA and the client's "collusion". This is consistent with the results of Chen Xin-Yuan and Xia Li-Jun's research. That is, audit tenure and audit quality are inverted U type relationship. We believe that this is consistent with the generally accepted view that long tenure audit tenure will impair the independence of certified public accountants, but can improve their professional skills.

Figure 3: The Simulation Results of the Effect Of Changing the Degree of Tenure on the BehaviorChoice



5. Discussion and Conclusion

- i) Independence and the integrity conduct of certified public accountants show a U - shaped relationship. The improvement of the degree of independence will promote the certified public accountants to choose honest behavior to some extent. However, when the degree of independence comes to a certain extent, the number of certified public accountants who choose honest behavior begins to decline. The certified public accountants with independence must truly have no benefit relationship with the clients and their attitude must be impartial in the auditing process. Besides, their professional judgment and audit opinion cannot dependent and succumbed to pressure from outside. Therefore, the higher the independence of the certified public accountants have, the more difficult to be dishonest in a certain degree. However, when the independence of certified public accountants comes to a certain extent, the certified public accountants will reduce their own requirements out of the pursuit of their own interests. As a result, they will choose the dishonest behavior. Here, we believe that there may be differences in the form of independence and substantive independence. The subsequent high degree of independence may be just a form of independence, so that the integrity conduct of certified public accountants begins to decline. So, when we research on the independence of certified public accountants, we should pay attention to distinguish the form of independence and substantive independence.
- ii) When the certified public accountants master the characteristics, business processes, accounting policies and other knowledge of the industry, they can improve their professional judgment and audit efficiency, so as to assess the fairness of the financial report more accurately and improve the audit quality. When the CPA's industry expertise comes to improve, the number of certified public accountants who choose honest behavior is also increasing. However, it can be seen that the industry expertise is not always improve the integrity conduct of the certified public accountants from the experimental results which is in line with the fact. When certified public accountants' industry expertise achieves a certain degree, their understanding of the industry gradually deepen. The certified public accountants believe that they have enough

confidence and ability to pad the bill and conceal their false audit information so as to increase the dishonest behavior.

- iii) At present, it is generally believed that long tenure can improve the professional skills of the certified public accountants, but will damage the independence. China began to implement the regular rotation system of signature accountant in 2004. At the beginning of the engagement, the certified public accountants rarely take the initiative to pad the bill because of the uncontrollability and great risks. After several years, the certified public accountants are familiar with economic activities and business process of the audited companies. They will choose dishonest behavior to help those audited companies. In addition, with the tenure becoming long, the link between the certified public accountants and the clients continues to deepen so that some certified public accountants allow the clients the requirements to issue false audit information. What's more, some certified public accountants help the clients cover up its false financial statements voluntarily. From the results of this paper, we can see that the tenure and certified public accountants' honest behavior is also a kind of inverted U type.

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