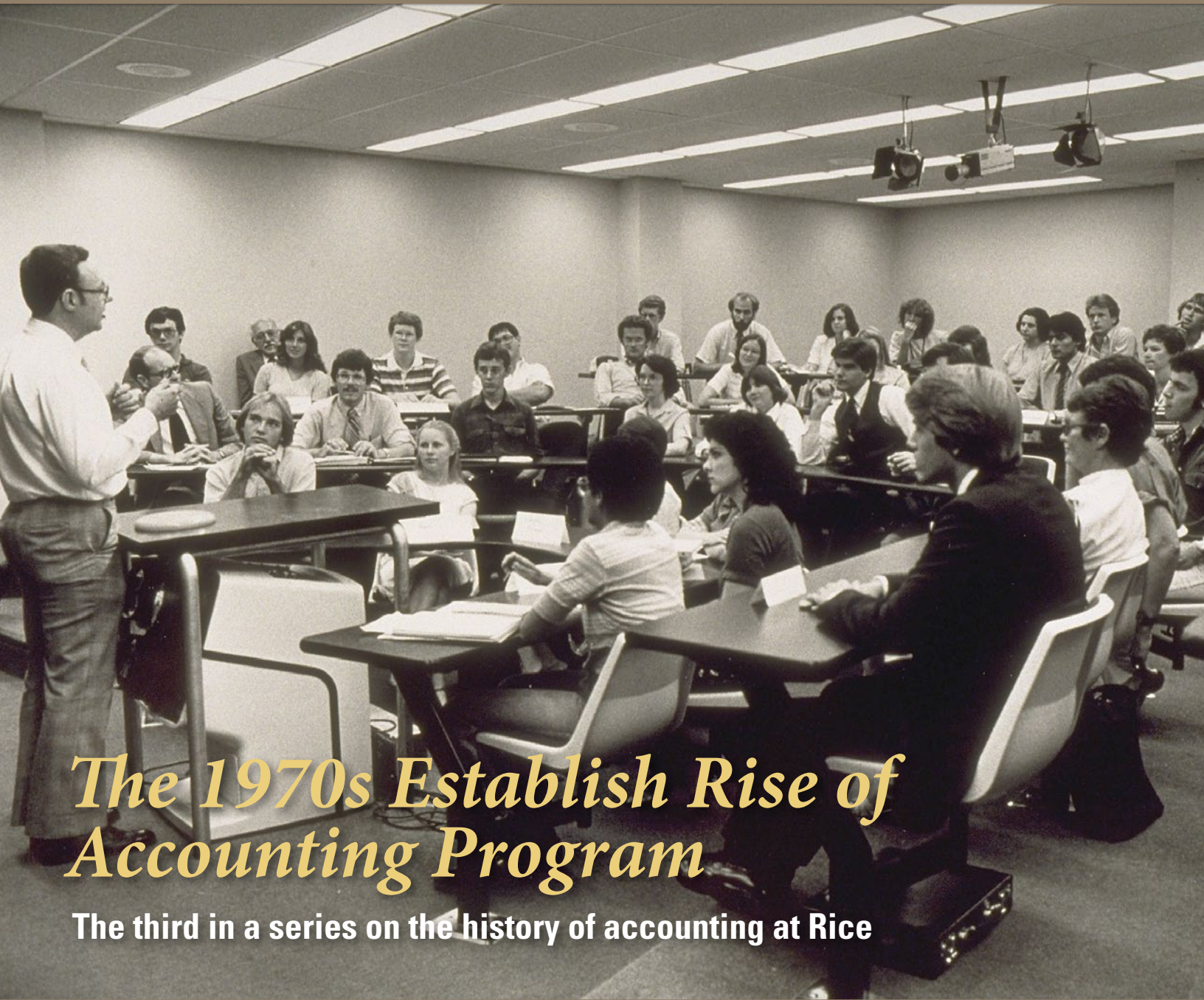


Spring 2014

# THE PARLIAMENT

NEWSLETTER OF THE JONES GRADUATE SCHOOL OF BUSINESS ACCOUNTING GROUP



## *The 1970s Establish Rise of Accounting Program*

The third in a series on the history of accounting at Rice

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# THE PARLIAMENT

A “parliament” is the literary collective noun for a group of owls. Similarly, the name of our newsletter reflects the collective spirit and wisdom of Rice Owls personified by the alumni, faculty and friends of the Jones Graduate School of Business accounting group.

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## Faculty Updates

### BRIAN AKINS

Brian Akins began teaching the core financial accounting course in the full-time MBA program this year. He was invited to give a presentation on academic methods for identifying earnings management to members of the FBI. Brian has also continued his research examining competition in the banking industry and begun new projects looking at credit rating informativeness and the effects of firm age on commonly used empirical measures of accrual quality.

### KAREN NELSON

Karen Nelson published her paper, “Are Individual Investors Influenced by the Optimism and Credibility of Stock Spam Recommendations?” in the *Journal of Business Finance and Accounting*. This paper is coauthored with Brian Rountree and former Rice faculty member Richard Price. She presented her latest research paper, “The CEO-Employee Pay Ratio,” co-authored with Steve Crawford and Brian Rountree, at the University of Chicago in April.

### BRIAN ROUNTREE

Brian Rountree was the recipient of two prestigious teaching awards in 2013. The first was selected by the graduating class for the Weekend Professional MBA program and the second was selected by alumni. Brian writes “It is a true testament to our accounting curriculum that so many of our accounting faculty win teaching awards. I am honored that the students think so highly of the courses I teach and particularly relish the fact that alumni find the class has relevance for their jobs.”

### STEPHEN ZEFF

Stephen Zeff was asked back to IASB and the FASB to give a professional development seminar to staff and board members. He published, “The Objectives of Financial Reporting: A Historical Survey and Analysis,” in *Accounting and Business Research* in 2013, and has recently published articles in the *Journal of Accounting, Economics and Law: A Convivium* and in *Accounting in Europe*. Together with a Dutch coauthor, he is completing a book manuscript on the history of the first ten years of the IASB, 2001-2011, for Oxford University Press.





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## *Greetings from the Accounting Area Coordinator*

I am happy to report that this has been a remarkable year as the Jones School strives to nurture and develop future thought leaders of the accounting profession and promote world class scholarship in accounting.

After approvals this year from the Rice faculty senate and the graduate council, the Master of Accounting degree is officially on target to begin in the fall of 2016. The re-launch efforts are being spearheaded by a committee consisting of K. Ramesh, Herbert S. Autrey Professor of Accounting; Brian Rountree, associate professor of accounting; Richard Viebig, lecturer in accounting; and Steve Zeff, professor of accounting and Keith Anderson Professorship in Business. We have a little over two years to roll out the program, but an immediate timeline is in place for marketing to potential students, including grassroots, website and advertising.

Rice undergraduates are slated to start the application process this fall. Time flies.

We are happy to announce that Dr. Benjamin Lansford will be the inaugural director of our MAcc program and will be joining the Jones School faculty as of July 1, 2014. Ben comes from Pennsylvania State University where he has been the director of their integrated Master of Accounting program since 2010. Look for more on his arrival in the coming months.

We have also had a great year in recruiting outstanding young tenure-track faculty from leading doctoral programs in the country. We are fortunate to have Patricia Naranjo join us July 1 from the Sloan School of Management at MIT, and Eric Floyd from the Booth School of Business at the University of Chicago. We welcome them!

The accounting group thanks the staff and faculty of the Jones School for their invaluable help and support. We also thank our alumni and friends for advice and guidance and look forward to their continued involvement and participation as the master's program gets underway in two years.

Finally, Karen Nelson, the Harmon Whittington Professor of Accounting, stepped down as the area coordinator at the beginning of this academic year, after serving in that role for many years. Under her inspired leadership, the accounting group grew tremendously in research stature and national reputation. We thank her for her contribution to our group.

With warm regards,

**Shiva Sivaramakrishnan**

*Henry Gardiner Symonds Professor of Accounting and Accounting Area Coordinator*  
Jesse H. Jones Graduate School of Business  
Rice University



# SABBATICAL ENERGIZES RESEARCH AND PRODUCTIVITY

BY BRIAN ROUNTREE  
*Associate Professor of Accounting*

As I sat down to reflect on what I learned during my six month sabbatical at the University of New South Wales in Sydney, Australia, I was reminded of the grade school essays we had to write each year concerning what we did over our summer vacation. Fortunately, I was considerably more productive during my sabbatical than my youth summer holidays.

When I was in the Ph.D. program at the University of North Carolina, I noted that there seemed to be a disproportionately high percentage of accounting scholars from Australia and New Zealand. Some of the biggest names in the field like Ray Ball, Phil Brown, Ross Watts, Doug Skinner, Richard Sloan, Patricia Dechow, Terry Shevlin, Paul Healy, etc. all came from these areas. Given the population of Texas is roughly the same size as Australia and New Zealand combined, clearly something fundamental was happening in accounting in these countries that lead to the production of great scholars. As a result, when I had the opportunity to take a sabbatical I decided it was the ideal time to immerse myself in this accounting culture.

It turns out that both countries have an option to graduate from the equivalent of our undergraduate institutions with honors by writing a research thesis. The thesis is an original piece of accounting scholarship that involves extensive reading of literature and identifying an underexplored area in the field. Thus, the education system is set up in a manner that encourages students to explore research at the undergraduate level not unlike a number of the highly acclaimed undergraduate programs at Rice University in the sciences. For years the U.S. has discussed the coming crisis in accounting education because of the diminishing numbers of new Ph.D.s granted each year. Based on what I learned in Australia, the answer to this particular problem seems to be relatively obvious: introduce students early in their academic careers to the research

that helps shape the manner in which we teach accounting so that students can begin to appreciate the attraction of a career spent learning and teaching. With the approval of the relaunch of the Master of Accounting program at Rice, I am excited about the prospect of not only producing some of the future leaders in the general accounting world, but also in the academic arena.

From a personal standpoint, the sabbatical allowed me the opportunity to think carefully about what types of research I would like to conduct over the next several years. It is very rare in any occupation to have an extended period to simply think carefully

*“It is very rare in any occupation to have an extended period to simply think carefully about an agenda, and I believe the benefits of such activity likely extend beyond just academia.”*

about an agenda, and I believe the benefits of such activity likely extend beyond just academia. Providing employees with incentives to seek out sabbatical opportunities that have clear objectives in terms of expanding one’s knowledge/mindset, but yet do not necessarily require immediate justification upon return can be very energizing, as well as productive. For me,

I successfully developed two original research papers with a co-author from the University of New South Wales during the six months I spent there. I presented one of those papers at five different institutions in Australia and New Zealand and have subsequently presented another paper at two different American Accounting Association meetings. Furthermore, I developed two additional research ideas capitalizing on what we learned from the earlier studies that are currently in the work-in-process stage. Upon returning to Rice, I found that my focus and energy in terms of both teaching and research has dramatically improved even though I had previously thought I was functioning at a very high level. I can say without hesitation that I have benefitted greatly from the sabbatical experience and although it was costly for Rice University to extend me this benefit, it is quite apparent to me that Rice has already received a return on its investment in terms of my increased productivity and dedication to my profession.

# SENIOR LEADERSHIP CHANGES AT THE JONES SCHOOL

*The year 2013 saw changes in the leadership of the Jones School, with two faculty members and one staff member taking on additional challenges and responsibilities to help lead the school further along its path of excellence.*



**K. Ramesh**, Herbert S. Autrey Professor of Accounting, was named deputy dean of academic affairs and assumed official responsibilities on July 1, 2013. He has previously served on business school faculties at Northwestern, University of Rochester, Penn State and Michigan State, where he was director of the accounting doctoral program. Ramesh served as academic fellow at the Office of the Chief Accountant at the SEC. His academic research has focused on capital market information environment, the role of accounting information in contracting and regulation, and financial information/disclosures and valuation.



**Barbara Ostdiek**, associate professor of finance, was named senior associate dean for degree programs and also began her new role on July 1. Her newly created position reflects an expansion and splitting of the senior associate dean role. Ostdiek's position is focused on innovation in the school's degree programs targeting distinct student and employer groups for each program. She continues her research and teaching as a member of the finance group. On the faculty since 1994, Ostdiek has taught a variety of courses across all of the degree programs, most recently Portfolio Management and Economic Environment of Business, and served for several years as academic director of the El Paso Corporation Finance Center. Her research focuses on investments and asset pricing.



Another key figure in the strategy planning and implementation is **Rachel Fleck**, whose appointment as assistant dean for external relations was announced in December 2013. In the last two-and-a-half years as JGSB director of development and as the interim external relations team lead, Fleck has been a driving force in raising philanthropic support and visibility for the Jones School. She has led key fundraising efforts, such as re-launching the Master of Accounting degree program, initiating the Military Scholars Program, supporting the Crownover Scholars Program and overseeing the management of the Jones Fund.

With those pieces in place, the school began a search for a new assistant dean of MBA programs, replacing **Sean Ferguson**, who was recruited by a global top ten MBA program at Hong Kong University of Science and Technology. The search committee has focused on identifying candidates with both extensive MBA program experience as well as strong business experience. The committee hopes to conclude the search by the summer.

# THE 1970s ESTABLISH RISE OF ACCOUNTING PROGRAM

*The third in a series on the history of accounting at Rice*

BY TODD JOHNSON

As the accounting program grew in the early 1970s, many of my advisees were inquiring about taking more of a business-type of curriculum as a major for their B.A. degrees. Although Rice offered a commerce program at the time, it was open only to scholarship athletes.

Since undergraduates had the option of developing an “area major” in place of a traditional major, I worked with them to develop one that included courses in accounting together with courses in economics, mathematical sciences, political science and psychology that were similar to those found in business schools. As more and more students became aware of that area major, they, too, opted for it. That area major formed the core of what later became the managerial studies program.

The impetus to formalize that area major into a well-defined major came from two sources. One was that a rapidly growing number of students were electing the major, therefore standardizing the curriculum simplified and facilitated the planning and advising process. Another was that the chair of the commerce program, Elton B. Hale, had proposed opening that program to all undergraduates and increasing its staffing (the program was then staffed by only one full-time faculty member, himself, supplemented by adjuncts), in part by absorbing the accounting program.

James Largay and I met with Hale to discuss his proposal but concluded that neither the accounting program nor our careers would benefit from being absorbed into the commerce program. In that setting, we proposed that, instead of opening the commerce program, the area major that I had developed for my advisees be formally adopted as an interdisciplinary major in “managerial studies.” (The proposal referred to the program as “management studies,” but the program soon was renamed.)

The program would be overseen by an interdisciplinary committee composed of representatives from each of the participating departments (economics and accounting, mathematical sciences, political science, and psychology). Since the proposed major would eliminate the need for the commerce program, it would be phased out.

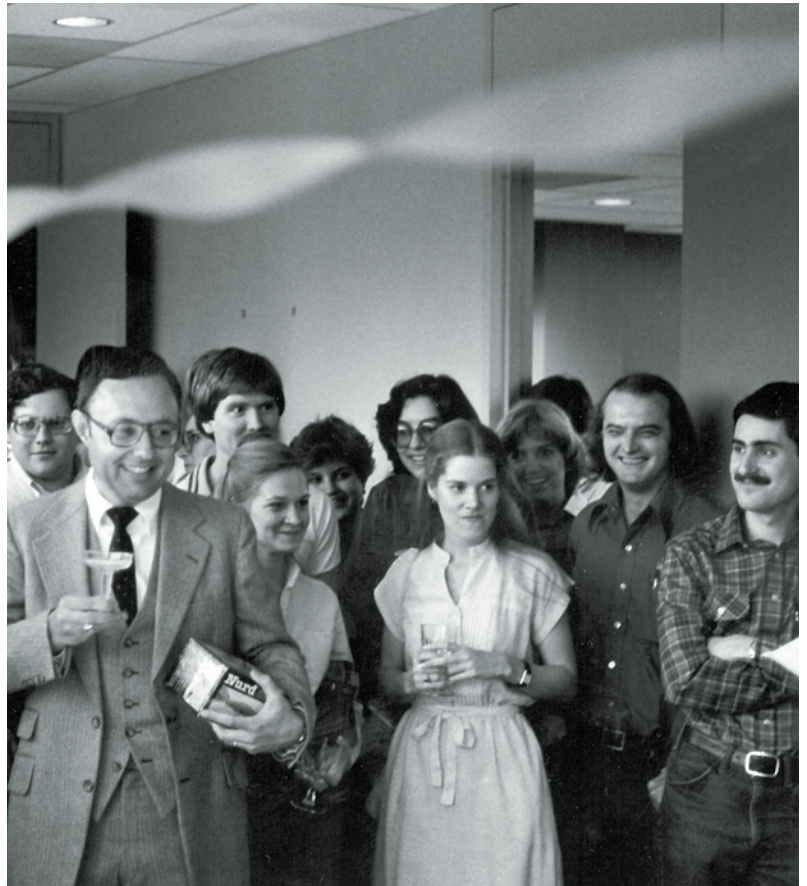
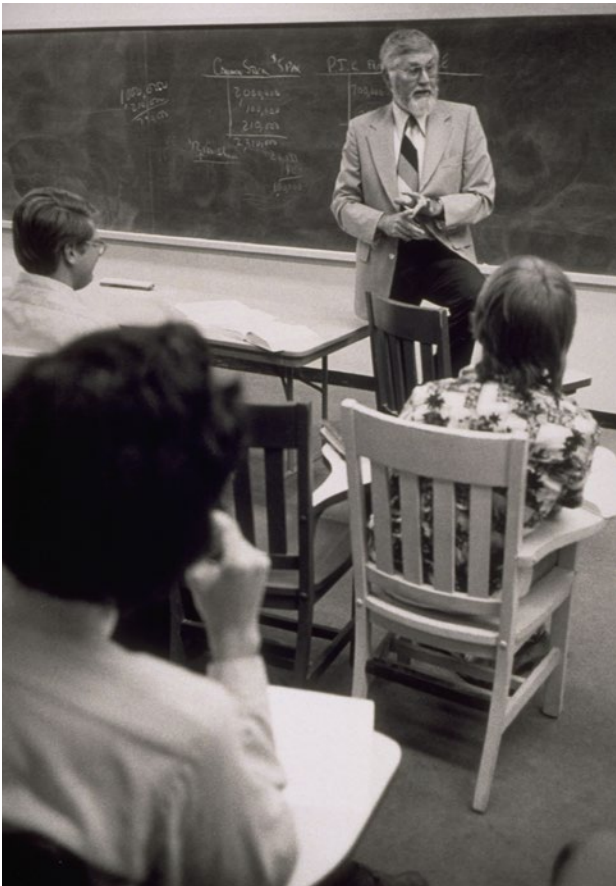
Gaston Rimlinger, chairman of the department of economics and accounting, presented the proposal to the general faculty in at a meeting in 1973. The faculty strongly approved the proposal, albeit with some concerns being expressed about the future of the program’s tenured faculty (Hale) following the phase-out. Rimlinger then urged President Norman Hackerman to appoint someone trustworthy as the first chair of the interdisciplinary oversight committee, worrying that it might afford the administration a back door opportunity to effectively continue the commerce program in some form. Hackerman responded that he intended to appoint Rimlinger, who quickly accepted, adding that “I trust myself.”

Following that approval, enrollments in the managerial studies program proceeded to grow rapidly, as illustrated in the following table.

## NUMBER OF MANAGERIAL STUDIES MAJORS AMONG GRADUATING SENIORS

<b>1973-74</b>	<b>13</b>
<b>1974-75</b>	<b>18</b>
<b>1975-76</b>	<b>41</b>
<b>1976-77</b>	<b>62</b>
<b>1977-78</b>	<b>58</b>
<b>1978-79</b>	<b>62</b>
<b>1979-80</b>	<b>99</b>





Many students elected it as part of a double major, often coupled with economics, as had been the case with many of the students who previously had elected it as an area major (in part because certain economics courses counted toward both majors). By the end of the 1970s, managerial studies had become the most popular major on campus, with about one out of six Rice graduates being awarded the degree in 1979-80.

The formalization of the managerial studies program added considerably to the enrollments in introductory accounting, and to a lesser extent, intermediate and cost accounting. However, from the time that the introductory course's enrollments first exploded in 1971, it drew a wide array of undergraduate students, not only from the social sciences and humanities, but also from the physical sciences and engineering.

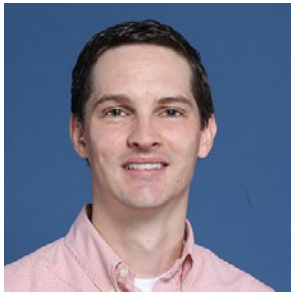
For example, two of the 1971 enrollees were John Doerr, an electrical engineering major, and Thomas R. Popplewell, a chemical engineering major. Both Doerr and Popplewell liked the introductory accounting course (and did well in it) and both went on to take more accounting courses while completing their engineering degrees. Doerr is now a partner in Kleiner, Perkins, Caulfield and Byer, a leading venture capital firm in Silicon Valley (and he delivered the 2007 commencement address at Rice).

Popplewell, rather than pursuing a career in chemical engineering, earned his MAcc degree, during the course of which he developed an interest in tax, and ultimately became a partner in Andrews & Kurth, a major law firm.

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*Todd Johnson taught in the department of economics and accounting at Rice from 1970 to 1979, when he took a leave of absence at the end of that fall semester to join the staff of the Financial Accounting Standards Board (FASB). Instead of returning to Rice at the end of his leave in 1982, he became professor of accounting and head of the accounting division and later associate dean of the College of Business and Administration at the University of Colorado at Boulder. Following four years there, he became professor of accounting and dean of the School of Business and Public Administration at the University of Houston-Clear Lake. In 1990, he returned to the FASB. During his tenure there he took a one-year leave to serve as Director of Research at the UK Accounting Standards Board in London. He recently retired from FASB as Senior Technical Advisor.*

# NEWEST PH.D. STUDENTS



Accounting Ph.D. student **Gary Lind** grew up in Alpine, Utah, and earned a music scholarship to Brigham Young University playing trumpet. “I learned in my first semester that the life of a musician wasn’t for me.” After his first year at Brigham Young University, he headed to the Dominican Republic

to serve a mission for the Church of Jesus Christ of Latter-day Saints. “I gained a confidence and self-reliance that have affected the rest of my life,” he said. “It was a deeply spiritual experience.”

Two years later, fluent in Spanish and with a perspective greatly expanded by enriching others’ lives, Gary returned to his studies at BYU. He played his trumpet in Synthesis Jazz Ensemble, and began his search for a major that took him from English to engineering, but it was a required course in economics that decided his course of study. “I loved economics from the first class,” he said. “One thing I love about it is the way it teaches you to think. You can apply that thinking to any field or discipline.”

During his undergraduate studies, Gary had the opportunity to conduct research. “I loved that part of it — the pursuit of knowledge and truth. I knew I wanted to earn a Ph.D.” On the advice of a professor, he looked into the economics program at Rice and applied. Once enrolled, an old friend who had just finished his Ph.D. in accounting recommended that Gary consider accounting at Rice. “But I had just started. I wasn’t even thinking about switching.” As his classes took a turn to financial economics, however, he became intrigued.

He met with Assistant Professor of Accounting Steven Crawford, who gave him a syllabus from the accounting Ph.D. program. “I read many of the accounting research articles and realized that my interest was actually in the more hands-on, applied research found in accounting.” After two years of economic study, he decided to switch Ph.D. programs. The change has been a good one. “This is the right fit,” he concluded.

The fifth child of eight, Gary met and married Sharon, a classmate at BYU, in 2008, and they have two children, Gordon, three, and Rosemary, one. The move to Texas has been happy, though they miss the snow and the skiing. Gary doesn’t have much time to make music anymore — with his studies and growing family — but, he said, “When things settle down, I might look into the jazz ensemble at Rice.”



Though she grew up the oldest of five children in Portland, Oregon, accounting Ph.D. student **Amoray Cragun** moved to Utah her senior year of high school and earned a scholarship to Utah Valley University (UVU). During college she tried her first accounting course. “I was picking classes my sophomore year, and accounting

was first alphabetically in the course list. I didn’t know anything about it so I signed up.” She liked it immediately and, more importantly, was good at it. “It clicked for me.”

She started doing research for Professor Sheldon Smith, and he became a mentor. “Working with him made me hungry for a higher level of research and study.” As a student on the dean’s list every semester and an outstanding Merit scholar all four years of college, she graduated summa cum laude and earned UVU’s student scholar of the year award for academic research and outstanding student of the year award in finance and economics.

It was because of Professor Smith’s mentorship that the mention of further study came about. “He was the one who encouraged me to apply for the BYU prep track.” By August she was enrolled. After that first year, she married her husband Nathan and took an internship with Ernst & Young in Portland for the summer. Back for her final semester at BYU, something happened that made Amoray set her sights on Rice. “Thomas Hemmer came and spoke at BYU about Rice’s Ph.D. program. I was totally sold.”

After graduating in December of 2011, Amoray returned to the job at Ernst & Young where Nathan also worked. For the next year and a half she worked diligently until he was transferred to Houston, and suddenly Rice felt more possible than ever.

A friend from her BYU cohort, Jonathan Bonham, was entering his second year in the Ph.D. program at Rice. Amoray and Nathan had dinner with Jonathan and his family. “I mentioned that I was going to try and apply next year, and he told me that they might be willing to accept another candidate for this year.” It was June.

“I had an interview with Thomas Hemmer and because I had done the BYU prep he was excited that I would know what I was getting into. Plus, I’m interested in analytical research, which is what Thomas does.” Within five weeks she was in. One year ahead of schedule. She started the Ph.D. program last fall and has taken on the challenge with enthusiasm. “I have especially enjoyed the accounting seminars. In Shiva Sivaramakrishnan’s introduction to accounting research, we could really talk openly about our ideas. Now I’m in Thomas Hemmer’s seminar, and I’m loving it.”

As of January 2014, there are 32 Rice Ph.D. in Business students, five of whom study accounting.



# VISITING ACCOUNTING FACULTY

## *A Reflection of Their Year*



### RICK JOHNSTON

With a strong mix of industry and academic experience, Rick Johnston joined the Jones School as a visiting assistant professor of accounting. “I like the energy of Houston,” said the native of Toronto, most recently living in the American Midwest. “I get to experience Texas and live in a

big city again.” Over nine years in senior roles at Ernst & Young and LPL Financial Services, the fourth largest broker-dealer in the U.S., Rick decided to go back to school to earn a Ph.D. “I’d been thinking about it since undergrad when I asked a question in class and the professor told me, ‘You’d have to do a Ph.D. to answer that.’”

He enrolled at the Wharton School at University of Pennsylvania. “Probably the best experience of my life, but hard on the ego.” Since graduating in 2004, Rick has accepted academic appointments with Ohio State University, Georgetown and Purdue before taking on the visiting role at Rice. He taught Financial Statement Analysis to both fully-employed programs. “I am impressed by the students. Of course there’s a difference in maturity and big picture experience between the executives and the professionals, but I’m amazed by their ability to fit the rigorous schooling in with their jobs and families.”

Rick’s impression of the accounting area at the Jones School? “Ramesh and (Thomas) Hemmer are tops in the field. It’s great to have exposure to such high caliber researchers.” Casual interaction with colleagues has also been beneficial. “Lunch with the finance faculty is great. They’re crazy smart, and the conversation is sometimes thought-provoking.”

With research interests in the empirical examination of the production and use of information, as well as its related consequences, Rick has published in the *Journal of Accounting and Economics* as well as *Contemporary Accounting Research* and has been cited in the *Wall Street Journal*. He has another paper on Operating Leases and Credit Assessment forthcoming in *Contemporary Accounting Research*, examining whether banks incorporate operating leases in their credit assessments through the interest rate charged on loans, the results raise the question of the need for new lease rules.

Rick earned his Ph.D. (accounting) and M.A. from Wharton; an MBA from University of Western Ontario, Canada; a C.A. from the Ontario Institute of Chartered Accountants; and a Bachelor of Commerce from University of Toronto, Canada.



### MELISSA MARTIN

An assistant professor of accountancy at W.P. Carey School of Business at Arizona State University, Melissa Martin describes the visiting position much like a foreign exchange student. “I take a leave of absence from my current position at ASU and come work at Rice for the year. It’s a good

way to open your research network, to teach in a different environment, and to see a new place.” Not that Houston is new to her.

A native Houstonian, Melissa returned to the city after college to take a position as staff auditor at Deloitte and Touche. She had always entertained the idea of a Ph.D. since a mentor at Texas A&M helped her understand what was involved in pursuing the degree. “After some time in public accounting I decided this was the profession I wanted. I love teaching and the challenge of creating new knowledge through research.” So she set off for the University of Southern California to earn a doctorate.

After five years teaching and researching at Carey, the Rice opportunity presented itself and she jumped on it. “First, I was incredibly excited by the chance to come home to Texas. As you know, it is a place like no other. Second, I feel fortunate to form new working relationships with the incredible faculty and pursue new research projects. The accounting area here at the Jones School is excellent. The faculty are world-class and the research environment is outstanding. I am also intrigued by the amount of work the faculty has put into restarting the MAcc program. I think the area has a great group of faculty who are dedicated to the success of the group and the students.”

The self-described “hard-working, dedicated teacher with a passion for research” focuses on issues faced by real firms using their data to understand the problems. “In addition, I am constantly trying to help students understand that accounting is not a course in math but a course in vocabulary. It is the vocabulary of business. Anyone can do the simple arithmetic, but if you do not understand the terminology, the numbers themselves become a foreign language.”

Melissa is teaching both the core managerial accounting course to all MBA groups and the control systems elective course. She earned her Ph.D. (accounting) from the University of Southern California, and an M.S. (finance) and B.B.A. (accounting), both *summa cum laude*, from Texas A&M University.

# ESTIMATES AND JUDGMENTS

## *Even Bean Counting Isn't as Simple as It Would Seem*

BY JOHN FOGARTY '78

What do accountants and auditors actually do? When my children were little they told people that their dad flew on airplanes – accurate and concise but a tad misleading. After more than 35 years in the auditing profession, I have consistently failed to describe to non auditors and accountants what we do. Here goes another attempt!

We make judgments, often subjective in nature, that result in information that others often perceive to be more objective and precise than it is. Accountants make judgments about measuring and disclosing financial events in order to fairly present financial statements. Auditors make judgments about the fair presentation of the financial statements and the adequacy of evidence to support their opinion.

### WELL-REASONED CONCLUSIONS

To make good judgments we must have knowledge and many skills – and we must be objective. Making judgments isn't simply having a point of view. A retired Deloitte & Touche LLP partner, Guy Moore, said it well in "Using Professional Judgment" (Auditing Section, AAA, The Auditor's Report), "Making professional judgments is hard and stressful work. Rarely is the data perfect and complete. The application of accounting and auditing standards to the circumstances frequently leads to various alternatives. And decisions must be made often within a relatively short period of time."

What do we mean by "judgment" and why is it so important? Merriam-Webster's dictionary defines it as "an opinion or decision that is based on careful thought." But what does judgment mean in accounting and auditing? Further insight from Moore explains that "Professional judgment is a process used to reach a well-reasoned conclusion that is based on the relevant facts and circumstances available at the time of the conclusion. A fundamental part of the process is the involvement of individuals with sufficient knowledge and experience. Professional judgment involves the identification, without bias, of reasonable alternatives...both professional skepticism and objectivity are essential to the process and to reaching an appropriate conclusion."

### MORE THAN A BOOKKEEPER

Why is judgment so important in accounting and auditing? Financial events and transactions are complicated. Even simple sounding things can be quite complicated. Take a classic example of accountants and auditors in popular culture – the bean counter.

But is counting beans really all that straight forward?

Consider some questions an accountant may need to consider when recording the value of beans in the financial statements of an agricultural cooperative. First – what is a bean? It matters what kind of bean we are counting because the market will pay different amounts for different types of beans. What is the source of the beans? Does the source affect the price? Are they organic? What does organic mean? What is the grade of the beans? Are they genetically modified? Are the beans fresh or are they too old or spoiled? Once the type of bean is established, – what are the markets? Are they observable? Active or thinly traded? Are there surplus beans on the market? Are these attributes objectively determined or are they a matter of subjective judgment? Maybe an expert in bean types and quality will be needed. If so, the accountant and auditor will need to be able to effectively communicate with the specialist, understand the methods and data used as well as evaluate competence and objectivity.

### ESTABLISHING QUANTITY AND VALUE

Assume there are many large bean silos. They are priced by the ton and weighed as they are put in the silo. Sounds simple. Add up the weights put in, subtract the weight taken out and that is your tonnage still in the silo. But were the weights going in and going out correct? Were some of the beans removed but not recorded? Did they spoil? The accountant will have processes and controls to make estimates such as controls over what can be added or removed from the silo and to establish the accuracy and completeness of records of beans coming in, going out, shrinkage and spoilage.

The accountant will also have physical inventory counts to correct the records to the actual physical quantity at a point in time. Historical experience is often used to estimate the amount of shrinkage and spoilage. But changes in conditions may render historical experience less effective in predicting current amounts and must be considered. This is one example of unintended bias that we should consciously consider when making judgments.

Now that we have the quantity of marketable beans they must be priced. Multiply the price per ton times the number of tons. Where does the price come from? Is the price paid to the farmer a contracted set amount? Is it market price? What establishes the market price? Is the market active and the prices observable? For some commodities observable markets exist. But, maybe not for

beans. How does the accountant determine what the market price is? Surveys? The government or other independent data gatherer? Relevant knowledge and experience are needed to make judgments about the price.

Once the accountant has established a quantity and value, consider the auditor's role. The accountant may have made mistakes, may have been biased or simply intentionally misstated the quantity and value. The auditor's role is to form a professional opinion as to whether the financial statements that contain the value of the beans are fairly presented in all material respects. Doing this requires the knowledge and experience of the accountant and the skills to conduct an audit. Accordingly, all the preceding questions are also relevant to the auditor's task. And the auditor has more judgments to make.

Who are the users of the financial statements? What in the financial statements is most important to them? What is material to the users of the financial statements? What are the risks of material misstatement related to inventory? Risk of misstatement depends on many factors, including what could go wrong, size of the account, historical experience, complexity and competency of the company personnel. Are the controls over inventory quantities and valuation designed and operating effectively?

#### HOW TO MAKE GOOD JUDGMENTS

If counting beans can be this involved, consider the complexities for other examples like the value of investments in private companies, real estate assets, or complex financial instruments without an observable market or observable inputs. Consider the complexities of impairment analyses of goodwill and long lived assets which depend upon estimates of future cash flows and discount rates. Likewise valuations of investments in private companies involve estimating future cash flows, terminal growth rates and discount rates.

I once had a conversation about how to make good judgments with Bob Garland, the leader of Deloitte & Touche LLP audit practice at the time. We made a list of the skills and knowledge needed to be a successful auditor. Here are some of them, in no particular order:

- Ethics
- Analytical reasoning
- Logic
- Organization
- Communication – written and verbal
- Intuition
- Curiosity
- Research ability
- Gathering data
- Processes and systems
- Internal controls
- Technology
- Business models
- Economics

- Legal structures and contracts
- Accounting standards and regulations
- Auditing standards and regulations

Accountants and auditors must have the ability to make judgments and to communicate the basis for their judgments to others. Not everyone is suited to this. Clear thinking, intellectual curiosity, consciousness of bias, and the ability to work under stress are all essential to the effective and successful accountant or auditor. Not all of these attributes can be taught, but a sound and broad education and a commitment to learning throughout life constitute a foundation for success.

What does this tell us about some of the most important aspects of accounting and auditing education?

1. The ability to reason is paramount.
2. Learning the “rules” is necessary but not sufficient. Practical experience is essential.
3. Faculty and students must be curious. Ask questions – Why? How do you know? Asking the right questions is as important as the answers.
4. Many conclusions are simply the best among alternatives, not absolutely right or wrong.
5. The ability to communicate complex matters in an accurate, concise, understandable manner is crucial.

Often accounting and auditing education concentrates primarily on the “rules” and leaves the rest for the student to gain through experience. This may be a disservice to the student, because they will likely enter the profession with an inadequate understanding of what accountants and auditors really do, and the activities they will have to perform. Formal education can incorporate all the essential aspects of judgment while learning the rules. I am looking forward to the graduates of the new MAcc program entering the profession. We need them now more than ever.

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