Underreporting Time: An Analysis Of Current Tax Practice

Dr. W. Robert Smith, Accounting, Georgia State University
Dr. Marguerite R. Hutton, Accounting, Western Washington University

Abstract

Public accounting firms use self-reported time from past projects to prepare time budgets for future projects, which, in turn, are used to schedule and evaluate personnel. Underreporting the amount of time actually worked may result in unrealistic future time budgets, high employee turnover, and lost revenues. The results of the research described in this paper indicate that underreporting by tax specialists is far more widespread and extensive than prior research suggests.

Introduction

Time budgets for tax returns and other tax projects are used for many purposes in public accounting firms. For example, time budgets may be used to schedule personnel, and comparisons of budgeted and actual time to complete a project may be used to evaluate employees. If employees and partners underreport the amount of time they actually spend on projects, a number of undesirable consequences may result. Researchers have attempted to determine the extent of and reasons for underreporting, but no recent studies have addressed this problem. Also, no research has focused on underreporting in a tax environment. In this paper, we provide evidence that this issue deserves additional analysis.

Literature Review

The issue of underreporting chargeable time was first addressed formally in a report by the Commission on Auditors' Responsibilities (1977). The Commission reported the results of a survey of individuals in local, regional, and national accounting firms that indicated that 55 percent of the respondents underreported chargeable hours in response to time pressure on audit engagements (Rhode 1977). The survey did not include auditors with less than three years of experience.

Alderman and Deitrick (1982) collected data from auditors at all experience levels and addressed issues not examined in prior research. A large majority of the respondents, 67 percent, said that they believe auditors underreport chargeable time, and 51 percent of the respondents said that they perceive time pressure as a significant determinant of audit behavior. Time budget pressure was thought by 58 percent of the respondents to be a major cause of senior and staff turnover.

The Alderman and Deitrick findings are consistent with a study by Lightner (1981) in which accountants who underreported time were found to have higher levels of psychosomatic responses and were more likely to indicate a desire to leave their employer than their colleagues who did not underreport. Surprisingly, there is no apparent relationship between underreporting behavior and job performance. Lightner pointed out some of the implications of these findings: 1. firms could lose some of their better auditors, and 2. those auditors who stay may experience psychosomatic responses from their behavior.[1]

The Lightner (1981) survey suggests factors that may contribute to underreporting behavior. Among those factors are time budget pressure, the ability to underreport time successfully, the influence of superiors, and the perceived rewards from underreporting chargeable time.

Lightner (1981) and Lightner, Adams, and Lightner (1982) found that approximately 65 percent of auditors say that they underreport the amount of time they spend on audit activities. In a survey of accountants from three national CPA firms, 67 percent of the respondents said that they underreport from one to nine percent of their total chargeable hours (Lightner, Leisering, and Winters 1983). These and other research efforts have focused on perceptions and motivational factors (See, Margheim and Pany 1986; Lightner, Leisenring, and Winters 1983; Lightner, Adams, and Lightner 1982; Alderman and Deitrick 1982; Fleming 1982; Lightner 1981; and Rhode et al. 1977). They paint a fairly consistent picture: a substantial percentage of auditors underreport the amount of time they spend on tasks, and no positive result of this behavior has been detected.[2]

Expectancy theory has been used extensively to explain behavior in organizations (Campbell and Pritchard 1976) including underreporting behavior in accounting firms (Lightner, Adams, and Lightner 1982). Lightner, Adams, and Lightner combined Lawler's (1973) expectancy model with situational and ethical variables to explain statements about underreporting behavior from subjects in three "Big Eight" accounting firms.

Lawler's model defines an individual's motivational force (MF) to engage in a behavior, such as underreporting, as the result of the following functions:

$E \rightarrow P$ = the perception that effort (for example, the effort required to underreport time) will bring about the desired behavior (lower reported time);

$P \rightarrow O$ = the perception that the desired behavior (lower reported time) will bring about outcomes or rewards (promotions, higher compensation, prestige, etc.); and

V = the importance attached to the outcomes or rewards.

A single motivational force, in this case, the motivational force to underreport time spent on a task, results from the combination of these functions in the following manner:

$$MF = E \rightarrow P[\Sigma(P \rightarrow O)(V)].$$

Because conflicting evidence exists as to the predictive ability of expectancy theory in professional settings (Compare Ferris 1976 (expectancy theory was not a good predictor of productivity variation among staff accountants) with Jiambalvo 1979 (expectancy theory predicted senior effort and performance)), Lightner, Adams, and Lightner (1982) combined expectancy variables questions with questions on normative beliefs about underreporting, past experience with supervisors requesting underreporting, the feasibility of meeting budgets, and circumstantial variables, including organizational levels, service areas, and firms. Three variables were found to be significant in a model that predicted the percentage of unreported time.

Consistent with Rhode's (1977) findings on the perceived importance of being able to meet budgets, budget feasibility was found to be the most significant explanatory variable in the Lightner, Adams, and Lightner (1982) study. Among subjects who did not strongly disapprove of underreporting, the motivational force to underreport postulated by the expectancy model was significant as well. Finally, requests from superiors were found to be a significant variable.

Method

We surveyed tax professionals at all experience levels in national, regional, and local firms around the United States. We sent a total of 296 questionnaires to local, regional, and national accounting firms in 13 cities across the United States. The questionnaires included questions about the amount of time subjects worked and underreported, their views on which situations caused underreporting, and the rewards that were likely to result from underreporting.

Results

Of the questionnaires distributed, 63 percent were completed and returned. Of those, 34 percent were upper management (partners or managers), 35 percent were senior accountants, and 31 percent were staff accountants.

An overwhelming majority of the respondents, 89 percent, reported that they underreported the amount of time they worked during the previous year. This suggests that a substantially larger portion of the public accounting workforce than has been

Table 1
Unreported Time Aa A Percentage Of
Total Time For The Year

Percent of Unreported Time	Percent of Upper Management	Percent of Seniors	Percent of Staff	Percent of All Subjects
0	11.1	13.8	6.9	10.8
1-4	28.6	41.5	41.4	37.1
5-9	30.2	16.9	29.3	25.3
10-14	19.0	15.4	15.5	16.7
15-19	7.9	7.7	1.7	5.9
20 or more	3.2	4.6	5.2	4.3
Total	100	100	100	100

TABLE 2
Maximum Unreported Time
In A Single Week
For Underreporting Subjects

Number of Hours	Percent of Upper Management	Percent of Seniors	Percent of Staff	Percent of All Subjects
1-4	35.7	48.2	32.7	39.0
5-9	39.3	23.2	44.2	35.4
10-14	10.7	10.7	11.5	11.0
15-19	5.4	8.9	5.8	6.7
20-24	5.4	5.4	3.8	4.9
25 or more	3.6	3.6	1.9	3.0
Total	100	100	100	100

reported in prior studies underreports. As shown in Table 1, 27 percent of the respondents indicated that they failed to report 10 percent or more of the hours they worked and 52 percent indicated that they failed to report 5 percent or more of the hours they worked.

Table 2 shows that, of those who underreported, 15 percent underreported 15 or more hours in a single week during the past year, 26 percent underreported 10 or more hours during a single week, and 61 percent underreported 5 or more hours during a single week. As a point of reference, Table 3 shows the average number of overtime hours per week during the most recent tax season.

Even though all of the firms in our sample had policies against underreporting, 48 percent of the respondents said that underreporting was very easy. Only 1 percent of the respondents said that underreporting was very difficult.

With respect to the perceived need to underreport, 16 percent of the respondents said that they would hardly ever meet time budgets if they reported all of the time they worked. A slightly smaller number, 15 percent, said that they would almost always meet time budgets if they reported all of the time they worked. The remaining respondents said that they fall somewhere between these extremes.

Most respondents, 90 percent, said that they were never *explicitly* asked to underreport, and 9 percent said that they were only occasionally explicitly asked to underreport. However, 57 percent said that they were frequently or occasionally *implicitly* asked to underreport. Although 89 percent of the respondents said that they underreport, as stated earlier, 50 percent of the respondents said that they disapprove or strongly disapprove of underreporting. Seniors and staff accountants were more likely to disapprove or strongly disapprove of underreporting, but only by a small margin (53 percent of seniors and staff accountants said that they disapprove or strongly disapprove of underreporting).

Table 4 summarizes responses concerning the perceived benefits of underreporting. A majority of the respondents said that they believe underreporting is likely to lead to better performance evaluations, being thought of as competent by superiors, job security, promotion and advancement, receiving better job assignments, and the firm being able to bill all their time to clients.

More personal rewards were not viewed as likely to result from underreporting. A minority of the respon-

TABLE 3
Average Number Of
Overtime Hours Per Week
During Tax Season

Number of Hours	Percent of Upper Management	Percent of Seniors	Percent of Staff	Percent of All Subjects
0	1.6	1.5	1.8	1.6
1-4	1.6	0.0	1.8	1.1
5-9	8.2	4.6	1.8	4.9
10-14	14.8	13.8	22.8	16.9
15-19	31.1	40.0	19.3	30.6
20-24	31.1	24.6	36.8	30.6
25 or more	11.5	15.4	15.8	14.2
Total	100	100	100	100

TABLE 4
Perceived Rewards From Underreporting:
Percentage Of Respondents Who Said Underreporting Is
Very Likely Or Somewhat Likely To Lead To Rewards

Perceived Reward	Upper Management	Senior	Staff	All Subjects
Better periodic performance evaluations	63.5	73.8	65.5	67.8
Superiors think you are as competent or more competent than others at your level	65.1	64.6	67.2	65.6
Feeling more secure about your job with the firm	41.3	52.3	60.3	51.1
Promotion and advancement	55.6	60.0	51.7	56.0
Assignments to jobs that are more interesting and challenging	55.6	56.9	44.8	52.7
Feeling of pride in meeting time budgets for most engagements	38.1	36.9	36.2	37.1
Firm's ability to bill all your time to the client	74.6	60.9	56.9	64.3
Feeling that you have contributed to your personal growth and development	7.9	16.9	17.2	14.0
Feeling that you are as competent as others at your level	20.6	10.8	20.7	17.2
Feeling that you have accomplished something worthwhile	14.5	10.8	12.1	12.6
Feeling of job satisfaction	11.1	9.3	12.0	10.8
Feeling better about yourself as a person	11.1	4.6	6.9	7.5

dents reported that they are likely to be proud of meeting budgets by underreporting. A minority of the respondents said that underreporting is likely to cause them to feel that they had grown or developed, were competent, or accomplished something worthwhile. A minority of respondents said that they receive job satisfaction and feel better about themselves as a person as a result of underreporting.

Table 5 summarizes the responses related to the circumstances that might give rise to underreporting. Respondents said that they underreport when they exceed time budgets, feel that they are not being productive, are too slow, or are unfamiliar with technical topics. That is, subjects tended to blame themselves, not others, for their underreporting behavior.

Discussion And Conclusions

Underreporting appears to be more widespread and extensive than prior research suggests, at least in the tax departments of public accounting firms. The three factors identified by Lightner, Adams, and Lightner (1982), budget feasibility, the motivational force to underreport, and requests from superiors, appear to influence current underreporting behavior among tax specialists.

Given that underreporting appears to be more widespread and extensive than ever, and given that upper management is the group least likely to strongly disapprove of underreporting, our first impulse is to suggest

TABLE 5
Underreporting Frequency: Percentage Of Respondents Who Said Situations At Least Occasionally Lead To Underreporting

Situation	Upper Management	Senior	Staff	All Subjects
You exceeded the estimated time required for the job as a result of an error on your part	65.1	60.0	63.2	62.7
You felt you were not productive on a particular job because you were "spinning your wheels"	71.4	58.5	68.4	65.9
You felt you were too slow	44.4	46.2	56.1	48.6
You had to complete additional work required by review notes on a particular job	32.3	40.0	36.8	36.4
You exceeded the estimated time required for the job as a result of new circumstances that arose after the estimated time had been established	40.3	36.9	37.5	38.3
You exceeded the estimated time required for the job as a result of lack of cooperation from the client	38.1	27.7	33.3	33.0
You felt your billing rate was higher than the service you provided to the client warranted	52.4	27.7	28.1	36.2
Additional hours were required due to your lack of familiarity with technical tax topics	52.4	58.5	50.9	54.1
Additional hours were required due to unfamiliarity with new law	47.6	40.0	42.1	43.2
You had to complete additional work to correct errors in work done by someone else within your firm	55.6	38.5	28.1	41.1
You did not exceed the estimated time required for the job	27.9	29.2	21.4	26.4

that accounting firms have, in effect, chosen to encourage underreporting and that their programs to promote such behavior are succeeding. All that remains is for upper management to convince employees at lower levels that underreporting is not unethical. Perhaps abandoning explicit policies against underreporting would accomplish this goal. Senior and staff accountants already perceive underreporting as in their best interest. Currently, a major problem appears to be that employees feel that underreporting behavior is unethical, and presumably, this creates cognitive dissidence when, as they perceive reality, they take unethical actions to promote their own self interest.

Upon further reflection, the problem appears to be one of balancing short-term and long-term goals and individual and firm goals. Surely, firms wish to minimize labor costs. Just as surely, individuals within firms wish to pursue individual goals such as advancement and being perceived as competent.

Upper management appears to be turning a blind eye toward underreporting, probably in a combined attempt to produce positive short-term results for the firm and good performance evaluations for themselves. The long-term effects on firms of employing, perhaps, slow employees, but more likely merely demoralized, unhappy employees, is not known, but additional research might show that the benefits gained from allowing underreporting are not as great as the costs.[3]

Accounting firms may be able to reduce underreporting in a number of ways. For example, feasible budgets appear to be an antecedent to the accurate reporting of time. While intuitively appealing, a firm policy of setting budgets at feasible levels may be very difficult to implement. Rapidly changing tax laws and a lack of historical data for new tax clients may thwart even the best efforts by firms to set realistic budgets. Also, such a policy, assuming implementation were possible, may yield little if claims of unreasonable budgets are, in fact, mere rationalizations of past behavior. There is some preliminary evidence, however, that subjects do not use budget feasibility merely as a justification for underreporting behavior (See Smith and Hutton 1994).

The underreporting problems caused by the budget-setting process suggest the need for technical solutions. That is, more precise techniques and technologies for predicting the amount of time required to perform tasks may be a fruitful approach to reducing underreporting. The other two significant variables in the Lightner, Adams, and Lightner (1982) study (the motivational force to underreport suggested by expectancy theory and requests from superiors) are interesting because they strongly suggest different types of firm intervention.

The motivational force to underreport suggested by expectancy theory appears to be driven by the perception that underreporting, at least in the context of budgets that are perceived to be unrealistic, results in better performance evaluations. The first two perceived rewards in Table 4 make this clear. This is especially true for staff accountants and senior accountants. The primary motivation for upper management appears to be the firm's ability to bill clients. This, too, is intuitively appealing since, presumably, upper management is more interested than senior and staff accountants in firm profits.

Suggestions for Future Research

Reducing the motivational force to underreport may be difficult in a culture that emphasizes efficiency and knowledge of technical material to such an extent that employees are willing to violate their own values to appear efficient and knowledgeable. That is, accountants believe that underreporting is wrong, but they are willing to underreport to receive better evaluations and be perceived as competent. If the motivational force to underreport is to be reduced, openness, education, and experimentation probably should be emphasized. Merely making all employees aware of policies against underreporting and firm commitment to such policies may be helpful.

Endnotes

1. The real-world drama of underreporting was expressed by one of the respondents in our study in an unsolicited letter. The respondent's words are far more eloquent than the statistics we present in the remainder of this paper:

   I believe the practice of eating time is widespread, especially among new hires or interns who want to get hired after the season is over. Last year I watched an intern work almost 80 hours in one week. Yet on his time sheet, he reported 54 total hours (charge and administrative). He had worked like that through the entire season. And it was no surprise when he was invited back as a permanent hire after [graduation].

   In the prior season, we had another intern who was logging a lot of hours off the books. She was hired permanently when the season was over. She is no longer with our firm as she could not keep on "eating" the amount of time necessary for her to look good. She suffered from burnout and began to miss days and leave the office early.

   I have decided that it is probably best for me to pursue a career [elsewhere]. ... I prefer not to work ... this hard and eat time to get ahead.
2. A potentially fruitful area for future research might be a comparison of the costs and benefits associated with underreporting. For example, firms that pay overtime might receive some benefit in the form of reduced wages when employees underreport. These benefits could be compared to the costs associated with higher employee turnover in a firm culture that allows or encourages underreporting.
3. High employee turnover seems to be an accepted fact of life in most public accounting firms. The respondents in our sample appear to be representative in this respect. Indeed, 24 percent of our respondents said that they do not anticipate being with the same firm for at least two more years. 51 percent said that they do not anticipate being with the same firm for at least five more years.

References

1. Alderman, C. W. and J. W. Deitrick, "Auditors' Perceptions of Time Budget Pressures and Premature Sign-offs: A Replication and Extension," *Auditing: A Journal Of Practice & Theory*, pp. 54-68, Winter 1982.
2. Campbell, J. P. and R. D. Pritchard, "Motivation Theory in Industrial and Organizational Psychology" in M. D. Dunnette (Ed.), *Handbook Of Industrial And Organizational Psychology*, Rand McNally, Chicago, 1976.
3. *Commission On Auditors' Responsibilities: Report Of Tentative Conclusions*, AICPA, New York, 1977.
4. *Commission On Auditors' Responsibilities: Report, Conclusions, and Recommendations*, AICPA, New York, 1978.
5. Ferris, D. R., "A Test of the Expectancy Theory of Motivation in an Accounting Environment," *The Accounting Review*, pp. 605-615, July 1977.
6. Fleming, M. M. K., "Budgeting Practices in Large CPA Firms," *The Journal Of Accountancy*, pp. 55-60, May 1980.
7. Jiambalvo, J., "Performance Evaluation and Directed Job Effort: Model Development and Analysis in a CPA Firm Setting," *Journal Of Accounting Research*, pp. 436-455, Autumn 1979.
8. Lawler, E. E., *Motivation in Work Organizations*, Brooks/Cole, Monterey, California, 1973
9. Lightner, S. M., S. J. Adams and K. M. Lightner, "The Influence of Situational, Ethical, and Expectancy Theory Variables on Accountants' Underreporting Behavior," *Auditing: A Journal Of Practice & Theory*, pp. 1-12, Fall 1982.
10. Lightner, S. M., "An Examination of Underreporting of Hours by Auditors in Public Accounting Firms," *Ohio CPA Journal*, pp. 97-100, Summer 1981.
11. Lightner, S. M., J. J. Leisenring and A. J. Winters, "Underreporting Chargeable Time: Its Effects on Client Billing, Future Budget Preparation and Staff Evaluation and Scheduling," *The Journal Of Accountancy*, pp. 52-57, January 1983.
12. Margheim, L. and K. Pany, "Quality Control, Premature Signoff, and Underreporting of Time: Some Empirical Findings," *Auditing: A Journal Of Practice & Theory*, pp. 50-63, Spring 1986.
13. Rhode, J. G., "Survey on the Influence of Selected Aspects of the Auditor's Work Environment on Professional Performance of Certified Public Accountants," summarized in *The Commission On Auditors' Responsibilities: Report Of Tentative Conclusions*, AICPA, New York, 1977.
14. ______, "Survey on the Influence of Selected Aspects of the Auditor's Work Environment on Professional Performance of Certified Public Accountants," Issued as *The independent auditors' work environment: a survey*, AICPA, New York, 1978.
15. Rhode, J. G., J. E. Sorensen and E. E. Lawler III, "Sources of Professional Staff Turnover in Public Accounting Firms Revealed by the Exit Interview," *Accounting, Organizations And Society* Vol. 2, No. 2, pp. 165-175, 1977.
16. Smith, W. R. and Hutton, M. R., Unpublished workingpaper, 1994.
17. Wright, A., "An Investigation of the Engagement Evaluation Process for Staff Auditors," *Journal Of Accounting Research*, pp. 227-336, Spring 1982.