Accounting is facing a labor crisis. Could fraud be part of the solution?

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The field of accounting is facing a labor crisis. From the high rates of baby boomer CPAs that are retiring to the 4% decline in the number of college graduates earning a bachelor's or master's degree in accounting since the pandemic, accounting is steadily losing members of its work force.

The drop in accounting professionals in the labor force has experts concerned with the potential for declining accountability in business financial reporting, which could have consequences as severe as leading to a rise in financial fraud.

With the loss of $2 billion in retiree pension funds from the Enron scandal of the early 2000s to the $8.9 billion in customer assets lost in the fallout of the recently-collapsed cryptocurrency exchange FTX, expert concerns about declines in accounting professionals who hold businesses accountable in financial reporting is notably valid.

Expert concerns of a potential rise in financial fraud with fewer accounting professionals in the field notwithstanding, fraud plays a surprising role in the accounting labor force, according to new research from the University of Florida.

The paper, "Externalities of Financial Statement Fraud on the Incoming Accounting Labor Force," is published in the *Journal of Accounting Research*.

"Research to date suggests that financial fraud can have damaging consequences, like increased criminal activity as well as reduced trust and participation in capital markets," said Assistant Professor Robert Carnes. "Insights from these studies imply that fraud would create a negative stigma around the labor market for all business fields, and accounting in particular, but we find the opposite."

Carnes, along with co-authors Paul Madsen of the University of Florida and Dane Christensen of the University of Oregon, find that incoming students are actually more likely to major in accounting when local frauds occur during their formative years. Specifically, the researchers find a 4% increase in the likelihood of majoring in accounting when local financial frauds are covered by the news media during students' formative high-school years.

"This size effect is modest," Carnes explained. "But we view it as meaningful because it suggests that fraud does not harm the flow of students into the accounting major, but rather it attracts more students."

The researchers' findings extend to other business majors, as well. Students who are exposed to local fraud during their formative years are more likely to choose to study subjects like business administration, finance, international business, management and marketing.

Compared to other business majors, however, fraud has a unique effect on the quality of students interested in joining the accounting field. The researchers find that students who are exposed to frauds in their formative years are also more likely to have the attributes desired by the accounting profession, like an increased academic aptitude (e.g., higher SAT and ACT scores) and a greater desire for public service work as opposed to commercial careers. These findings are stronger when frauds receive higher media attention.

"Overall, our results seem to arise from situations where students, or those who influence their career decisions, are more likely to have been aware of the frauds," Carnes noted. "These local frauds may influence student self-selection into the accounting major by providing them and their advisors with new information about—or attracting their attention to—the accounting profession."

The impacts of fraud on students extends into their time in college and post-graduation outcomes. In a supplemental analysis of educational and labor market data of more than half a million accounting graduates in the

United States, the researchers corroborate their initial findings with data suggesting that accounting graduates with higher rates of fraud exposure in high schools are more likely to (1) work in an accounting job, (2) go into public accounting, (3) work for a Big N accounting firm (like today's Big 4, which includes Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers) and (4) become Certified Public Accountants.

More information: Robert R. Carnes et al, Externalities of Financial Statement Fraud on the Incoming Accounting Labor Force, *Journal of Accounting Research* (2023). DOI: 10.1111/1475-679X.12501

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