

7-1-2023

In-house preparation, outsourcing, or offshoring of tax services to third-party service providers: Does disclosure to the client matter?

Renu Desai

Nova Southeastern University, rdesai@nova.edu

Vikram Desai

Nova Southeastern University, vdesai@nova.edu

Julia Davidyan

Nova Southeastern University, jdavidya@nova.edu

Andrew Felo

Nova Southeastern University, af878@nova.edu

Follow this and additional works at: https://nsuworks.nova.edu/hcbe_facarticles



Part of the [Business Commons](#)

NSUWorks Citation

Desai, Renu; Desai, Vikram; Davidyan, Julia; and Felo, Andrew, "In-house preparation, outsourcing, or offshoring of tax services to third-party service providers: Does disclosure to the client matter?" (2023). *HCBE Faculty Articles*. 1176.

https://nsuworks.nova.edu/hcbe_facarticles/1176

This Article is brought to you for free and open access by the H. Wayne Huizenga College of Business and Entrepreneurship Faculty Publications at NSUWorks. It has been accepted for inclusion in HCBE Faculty Articles by an authorized administrator of NSUWorks. For more information, please contact nsuworks@nova.edu.



In-House Preparation, Outsourcing, or Offshoring of Tax Services to Third-Party Service Providers: Does Disclosure to the Client Matter?

Renu Desai
Vikram Desai
Julia Davidyan
*Andrew Felo**

1. Introduction

“Do you know who is preparing your tax return?” This simple question might be asked of clients every year and is also the title of an article by a *Forbes* contributor, discussing the “secret” of outsourcing and offshoring in the tax business (Gorman, 2018). Absent publicly available data, unofficial estimates suggest there are millions of annual returns being outsourced and offshored (Gorman, 2018), prompting the ultimate question of how did we get here and does disclosure of “who prepares the tax return” matter to the client?

In the early 2000s, members of the U.S. Congress, the media, and state and federal regulators debated a number of issues regarding the responsibilities of businesses to disclose to their customers and clients when they outsource services or production to other countries (AICPA, 2005a). As a result, the AICPA Professional Ethics Executive committee (hereafter PEEC) undertook a project to assess whether or not the AICPA Code of Professional Conduct (the “Code”) sufficiently addressed the members’ obligations when outsourcing services to third party service providers (hereafter TPSP) (AICPA, 2005a). The PEEC examined the effect that outsourcing of accounting and tax services has on integrity, objectivity, compliance with standards and confidential client information. In early 2004, the PEEC issued an exposure draft, and finalized its ruling the same year.

The new pronouncements took effect for all professional services performed on or after July 1, 2005.¹ The newly-added requirements, which remain in effect as of the most recent version of the Code (effective December 15, 2014), state that if the member intends to use the services of a TPSP, the client should be informed and be given the opportunity to ask questions concerning the use of the service provider. Additionally, members have the option to obtain specific consent from the client to disclose their confidential information or enter into contractual agreements with any TPSP to maintain confidentiality of the clients’ information (See Appendix A).

Previously, the Code did not require disclosure to the client when a member used a domestic or overseas TPSP (AICPA, 2005a). However, the AICPA’s revision may not have met the professional obligation to put clients’ interests above members’ interests in using the non-mandatory word *should* instead of *must*. Furthermore, the revised requirement does not differentiate between outsourcing domestically and outsourcing overseas, also known as offshoring.² With the current disclosure requirement (if a member chooses to inform in writing), a member’s clients are informed that a TPSP *may* prepare their returns. The practitioner does not necessarily have to inform the client of the geographical location of the TPSP. The TPSP may be within the U.S. or the return may be offshored to a remote location such as India (AICPA, 2005b). This action can be considered a significant area of concern because there are ethical and economic considerations involved in offshoring of professional services such as tax return preparation that are distinctly different from outsourcing returns within the U.S. (Nouri and Lafond, 2012; Roberston, Lamin, and Livanis, 2010; GAO, 2005).

¹ They did not apply to professional services that were performed pursuant to agreements that were in existence on June 30, 2005, that are completed by December 31, 2005.

² Outsourcing of returns involves partnering with a service provider located within the U.S. whereas offshoring of tax return preparation involves partnering with an outsourcing facilitator situated overseas.

Outsourcing risks specific to tax return preparation include the competence of the preparers and the protection of the information sent outside of the immediate control of the CPA firm. Arguably, CPA firms may have adopted measures to ensure that preparers are competent and client information is protected, ensuring that clients' interests are no less protected than if the CPA firm had prepared the return in-house. However, the focus of this study is not whether offshoring of tax returns is more risky than outsourcing domestically or whether the CPA firms have adequately managed the additional risks that arise from offshoring. Our focus is on the question of whether the disclosure made to the clients regarding outsourcing or offshoring of their returns is adequate. Ethics dictate that tax firms should provide their clients sufficient information for them to make informed decisions about whether their returns should be prepared in-house or outsourced (whether within or outside of the U.S.), based on their own risk assessment.

The purpose of this study is to explore the adequacy of the AICPA's recommended outsourcing disclosure and the resulting ethical and economic repercussions for both AICPA members and their clients. The specific issues we address are: members' professional responsibilities to their clients, the scope of their contract and the resulting contracting problems; and members' motivations to conceal privately held information, suggesting opportunistic behavior by AICPA members.

We examine the behavior of clients of CPA firms that are outsourcing returns within the realm of the contract entered into for tax return preparation and analyze the repercussions of two contractual issues, disclosure and pricing, on both contracting parties. This study presents direct experimental evidence about how individual taxpayers might react to disclosures made by tax preparers regarding their outsourcing relationships with TPSPs. We build our hypotheses using the theory of social contracts (Oosterhout, Pursey, Heugens, and Kaptein, 2006) and search theory of economic rationality (Stigler, 1961) to analyze the reaction of individual taxpayers to the disclosure strategy and the pricing strategy adopted by tax preparers.

This study is important for several reasons. First, it contributes to the contractual business ethics literature by empirically testing the Oosterhout et al. (2006) contract model in a tax return offshoring setting. Second, it uses social contract theory to understand the contract between taxpayers and tax preparers. Thus far the notion of social contract has been explored in tax research in relation to tax compliance and tax evasion (Vihanto, 2003). This stream of research is centered on the contract between the government, which serves as the agent liable for enforcing the tax rules and entitled to use force toward this end, and the taxpayer. The contractual issues between tax preparers and taxpayers are at the forefront of the offshoring practice and investigating the finer nuances of this relationship provides insight into the disclosure strategy adopted by the tax preparers, i.e., AICPA members. Third, it identifies an economic motive for AICPA members to not voluntarily disclose information about outsourcing or offshoring tax return preparation. Finally, to our knowledge, this study is the first to utilize an experimental methodology to address these questions in the tax services context. Prior research in the area of the impacts of outsourcing and offshoring is predominantly focused within the auditing context, which is not of immediate concern to the individual consumer (Canning, O'Dwyer, and Boomsma, 2022; Didia, Mayse, and Randle, 2018; Lyubimov, Arnold, and Sutton, 2013). By examining the impact of disclosure to the client of outsourcing or offshoring tax return preparation services, the study suggests important public policy implications for the protection of consumers who are the most vulnerable to the detrimental effects of offshoring. The findings of this study may lead regulators to review the adequacy of the current disclosure rules, resulting in changes to benefit clients.

The article proceeds as follows. The next section provides a background of the outsourcing and offshoring phenomenon and the shortcomings identified in the revised AICPA ethics rulings included in the current version of the Code. Section 3 describes the development of testable hypotheses. Section 4 details the experimental methods. The analysis of results is presented in Section 5. The study concludes with a discussion and conclusion in Section 6.

2. Background

2.1 Outsourcing and Offshoring: Pros and Cons

The Federal Deposit Insurance Corporation (FDIC) conducted a study of the risks of offshoring by financial institutions from a safety and soundness perspective, with a particular emphasis on the threats posed to customer privacy in June 2004. Their findings recommended disclosure of undisclosed third-party contracting arrangements since they may increase risk in outsourcing relationships. This potential increase in risk occurs regardless of whether the undisclosed third party is a domestic or offshore vendor. However, the inherent risks to outsourcing may be amplified due to unique country risk when the third party is an offshore vendor.

In addition, offshoring includes intrinsic risks of location, caused simply by moving activities to remote locations. Some of these are geopolitical risks; for example, moving activities to India creates an exposure to the potential of violent escalation of conflict between India and Pakistan. Even in Europe, the violence resulting from Russia's invasion of Ukraine threatens the future of outsourced technology services to the booming Ukrainian region (Bousquette and Bhattacharyya, 2022). In addition, using offshore vendors could subject clients to greater risk from higher levels of corruption outside of the U.S. For example, the U.S. ranked 27th out of 180 countries on the Corruption Perceptions Index (Transparency International, 2021). For comparison, India (85th), Ukraine (122nd), and Russia (136th) all ranked higher (more corrupt), and therefore, more risky. Thus, offshoring tax returns from the U.S. to such countries would further suggest that returns are being prepared in higher corruption environments.

The outsourcing and offshoring of professional services has raised ethical questions regarding integrity, objectivity, disclosure, and client confidentiality (Mintz, 2004; McGee, 2005). Proponents of outsourcing tax compliance work offer a number of reasons for its popularity (McGee, 2005). For example, outsourcing can free accounting professionals from devoting time to routine tasks, enabling them to offer an extended range of client services while providing faster and less costly services (Robertson, Stone, Niederwanger, Grocki, Martin, and Smith, 2004). On the other hand, there are concerns that outsourcing limits the tax preparation experience of entry-level accountants (Fogarty, Sellers, and Jones, 2021) and may lead to decreased staff morale due to staff concerns about layoffs (Robertson et al., 2004). Further, technological needs to move manual processing to a web-based processing system (e.g., computer hardware, computer software, data storage, and IT professionals) may act as a deterrent to effective outsourcing.

In addition to risks from using domestic vendors, using offshore vendors in preparing tax returns results in other unique costs and benefits. Critics of offshoring claim that one of the greatest concerns about offshoring is the privacy and security risk of providing confidential client information such as social security numbers to an overseas facilitator's website (Robertson et al., 2004). However, some AICPA members argue that the concerns regarding the security and confidentiality of data are unfounded. They insist that reputable TPSPs institute security measures that far exceed the measures applied by numerous accounting firms within the U.S. (AICPA, 2005a).

Clients' assessment regarding whether or not to favor outsourcing or offshoring may vary as well. For example, clients may differ in their opinions on the likelihood of their information being compromised and on the severity of those risks when offshore vendors are used. Further, clients may be more opposed to offshoring of returns due to patriotic concerns (Robertson et al., 2004). While most taxpayers do not want their sensitive tax return information ever made public (Soled, 2005), they may differ on whether outsourcing or offshoring increases this risk.

On the other hand, some clients may favor lower fees that may be offered as a result of the decrease in expenses from outsourcing or offshoring. One of the greatest motivations for CPA firms to outsource preparation of tax returns, domestically or overseas, is cost arbitrage (Lombardo, 2003). The ability to reduce expenses through reduced staff (whether full-time or temporary, can result from both outsourcing and offshoring of services. Tax preparers may pass on a portion of these cost savings to their clients in the form of reduced fees which may be attractive to clients who value cost savings. Offshoring of returns provides added benefits over and above outsourcing such as the practical efficiency resulting from an overseas workforce coupled with advanced technology that enables speedy data transfer. The time-zone differences create virtual 24-hour operations since the daily close of operation in U.S. accounting firms coincides with the start of the workday for overseas accountants. Thus, offshoring can improve client service by speeding the delivery of completed returns (Robertson et al., 2004). At the same time, questions regarding quality remain. In a study conducted by Hageman and Fisher (2016) regarding the organizational climate of tax firms, the authors find that "... tax professionals are less likely to engage in questionable behavior when they perceive that the firm has a good system for monitoring or tracking client service quality" (p. 57). However, if tax preparation is outsourced or offshored, how much of the firm's monitoring and tracking would be needed to ensure the same client service quality?

Finally, clients of tax firms may have patriotic concerns about the offshoring of tax preparation work (Robertson et al., 2004). Recent events have intensified patriotism throughout the U.S. and many U.S. workers have lost jobs to cheaper third-world labor. Clients may view offshoring as yet another myopic approach that needlessly diminishes the U.S. job market (Shamis, Green, Sorensen, and Kyle, 2005). A survey about public accountants' disclosure of tax return preparation outsourcing indicates that more than 84% of the people who used a tax preparer considered offshoring of their returns to be a significant cause for concern (Brody, Coulter, and Jewell, 2006). The above discussion reinforces our argument that offshoring of returns raises concerns that are distinct from outsourcing domestically. It imbeds a degree of skepticism into

the AICPA's apparent position that the taxpayers are indifferent between in-house preparation, outsourcing, or offshoring of their tax returns.

However, we argue that it should be the client's prerogative to make the decision about whether their return should be outsourced, offshored, or prepared in-house, given all the relevant information and after they weigh the costs and benefits involved. The Code's ambiguity and leaving the judgment and professional responsibility to the member could be an attempt by the AICPA to use its expertise to make decisions for clients who may not possess, in the AICPA's opinion, the knowledge, expertise or requisite information to make their own decisions (Dwyer and Roberts, 1998).

2.2 AICPA's Code of Conduct: Shortcomings in the disclosure rules

The revised AICPA ethics rulings contain provisions that may provide different interpretations to different readers. Differing interpretations can cause contracting problems between clients and firms. These problems can then lead to frustration and the end of the relationship. Therefore, gaining an understanding of the shortcomings in the rulings may be an important step towards reducing information asymmetry between clients and AICPA members.

2.2.1. Section 0.400.47 Definitions and Section 1.150.040 Use of a Third-Party Service Provider

This section of the Code (See Appendix A for complete wording) was issued to provide guidance with respect to a member's responsibilities when using TPSPs to provide professional services to clients. The new requirements mandate that AICPA members should inform clients, preferably in writing, when they use TPSPs to provide professional services such as outsourced bookkeeping, tax-return preparation, consulting and attestation services excluding administrative support services (AICPA, 2014).

In addition, the Code does not describe what a TPSP "is"; it describes what it "is not" (See Appendix A). Also, the format of the current disclosure allows the disclosure to be made as a part of documents such as a tax organizer or in the standard privacy policy letters provided to taxpayers, thereby potentially reducing its accessibility to clients.

2.2.2 Section 1.300.040 Use of a Third-Party Service Provider (Interpretations Under the General Standards Rule)

The rules specify that members remain responsible for providing adequate oversight for all services performed by TPSPs and they must adequately plan and supervise such services and obtain sufficient relevant data to support the work product. However, there may be difficulty in operationalizing the assumption of responsibility. In asking a member to be responsible for the "adequate oversight of all services performed by the TPSP and for ensuring that all professional services are performed with professional competence and due professional care," apparently the AICPA expects the TPSP to adhere to the ethics standards that the member is bound by (See Appendix A for complete wording).

2.2.3 1.700.040 Disclosing Information to a Third-Party Service Provider (Interpretations Under the Confidential Client Information Rule)

This section of the Code (See Appendix A for complete wording) states that a member should either obtain a specific consent from the client regarding confidential client information disclosure or enter into a contractual agreement with the TPSP to maintain the confidentiality of the client's information. Additionally, a member should use reasonable care to determine that the third-party has appropriate procedures in place to prevent unauthorized release of confidential client information to others.

These provisions are challenging for multiple reasons. First, AICPA members may lack the technical competence to review the procedures in place to prevent unauthorized release of confidential client information. Second, confidentiality agreements with a TPSP may not be an adequate substitute for specific client consent when services are to be rendered by a TPSP that is outside the jurisdiction of the U.S. legal system. Last, since there are no requirements in the Code to inform clients that a contractual confidentiality agreement is in place with a TPSP, the AICPA may be free riding on claims of professional care, responsibility, and due diligence by passing on the responsibility to the TPSPs and may be taking advantage of the information asymmetries that exist due to the inability of the clients to monitor their activities.

2.3 Internal Revenue Service (IRS) Consent to Disclose Requirements

The AICPA's reluctance to secure client consent demonstrates its intention to extend the scope of the contract entered into between taxpayers and tax preparers. While the IRS does have rules regarding this situation, these rules are subject to limitations. Under Treasury Regulations section 301.7126-3(a)(3)(i)(D), taxpayer's consent is always required

before disclosure to preparers outside of the U.S. (Rule, 2019). However, “the consent is usually part of the engagement letter and appears so innocuous that unless you read it and ask questions, you might not realize that you are agreeing to have your return sent overseas to tax preparers who are not employees of the tax firm you engaged to prepare your return,” (Gorman, 2018). Furthermore, these regulations fall short of requiring a disclosure regarding where specifically (country or region) ‘outside the U.S.’ client information is being sent.

Gorman (2018) also notes that “there must be stricter transparencies on the cost, the risks, and the quality of outsourcing.” It should be up to a well-informed client who is provided all of the relevant information (not just some of the relevant information) to make the informed decision whether to them, the cost savings outweigh the risks of outsourcing or offshoring. Yet, the AICPA is relying on the ethical judgement of its members when it comes to educating and clearly indicating to their clients the implications of the consent. Clifford, Grossman, Johnson, and Tervo (2019) suggest that tax practitioners and their clients should have open conversations regarding risk tolerance and ambiguous tax positions. In a similar manner, should not tax preparers have open conversations regarding the outsourcing or offshoring of tax preparation with their clients?

3. Hypotheses Development

We use both economic-based and sociology-based theories to develop three sets of hypotheses. The first set of hypotheses provides taxpayers’ reactions to the disclosure strategy adopted by the AICPA member. The second hypothesis provides taxpayers’ reactions to the pricing strategy adopted by the AICPA member. The third hypothesis addresses the possibility of an interaction between the disclosure strategy and pricing strategy on the reactions of taxpayers. The theory of social contracts (Oosterhout et al., 2006) provides the theoretical understanding underlying the first set of hypotheses and drives the disclosure strategy variable. Donaldson and Dunfee (1999) have argued that the rules of business ethics should be based on norms determined by communities since communities, geographic or other reference groups determine what is appropriate. In the context of the ethical norms related to the conduct of AICPA members, the “community” involves any combination of stakeholders such as clients, the business community, and regulators. The focus of this study is the AICPA members and how their code of ethics should reflect responsibilities to a particular set of stakeholders, their clients.

3.1 Hypothesis 1: Taxpayers’ response to firm disclosure strategy

Social contract theory is grounded in the appealing idea that human interaction and association should be guided and constrained only by those norms and institutions that freely consenting agents could and possibly would agree to if they had the choice (Hampton, 1993). Oosterhout et al. (2006) direct our attention to two behavioral assumptions that economic organization theory has identified as highly relevant in the context of contracting (Williamson, 1985). The first assumption is that contractors may sometimes be subject to overly self-regarding or opportunistic tendencies that lead them to exploit the freedom they enjoy in moral free space by unjust means (Williamson, 1985). The second assumption is that contractors are subject to bounded rationality (Simon, 1998) or cognitive limitations that interfere with their ability to rationally devise norm-generating contracts within moral free space. They confront these two behavioral assumptions with two normative expectations guiding all contractual relations, reciprocity, and effectiveness.

This produces an idealized set of four contracting problems representing their version of the state of nature: the predicament in which contractors find themselves when there is no internal morality of contracting in place to guide and constrain their behavior. These general contracting problems that contractors must strive to avoid when engaging in extant contracting practices are desolation, defeasance, deception, and defection. These problems are operationalized in this study as three potential contractual problems in the social contract between an AICPA member and the client. Each of these problems corresponds to the contracting problems identified by Oosterhout et al. (2006) and is discussed in detail below. Figure 1 provides the framework to guide the first hypothesis. This figure indicates that the AICPA member-client relationship is indicative of three contracting problems: veiling the identity of the TPSP, lack of specific client consent, and concealing privately held information. An analysis of contracting problems helps identify the possible motivations underlying the recommended disclosure strategy in the revised ethics rulings. [See Figure 1, pg. 305]

Veiling the Identity of the TPSP

The problem of desolation is described as veiling the identity of the TPSP in the tax offshoring scenario and is situated in the upper left-hand corner of the Oosterhout et al. (2006) model (See Figure 1). The problem of desolation suggests that a contract will not be created unless all parties anticipate some gain from it. Yet the behavioral condition of bounded rationality may limit the ability of potential contractors to envision such gains. In the context of tax return

offshoring, the AICPA member will definitely reap economic gains. However, desolation may arise because the client may perceive offshoring as not beneficial to him or her. The question that arises is why the client believes that offshoring is not beneficial. Before returns were offshored, the client used the identity of the AICPA member as a proxy for quality, which guarantees a certain minimal level of performance, since his or her bounded rationality limits his or her knowledge of the quality of tax returns. When returns prepared by AICPA members are offshored, if the identity of the AICPA member is substituted for a TPSP, the client may perceive the quality of the tax return to be lower. Thus, the client may want to rescind the contract. To avoid this problem, the member prefers to veil (or hide) the identity of the TPSP.

AICPA members may fear that once the identity of the TPSP is revealed, the clients will not return to the firm the following year leading to a loss of revenue. The primary motivation for an AICPA member to adopt a disclosure strategy that veils the identity of the TPSP is to maximize the likelihood of clients returning to the CPA firm the following year for tax return preparation. Thus, we hypothesize that AICPA members believe revealing the identity of TPSP will lower the client's likelihood of returning to the CPA firm, providing a motivation to use a disclosure strategy that conceals the identity of the TPSP over a strategy that reveals that the returns are being offshored.

Failure to Procure Specific Client Consent

The term defeasance indicates the possibility of a contractual scheme becoming mis-aligned with contractors' interests because of unforeseen contingencies. This situation happens, for example, when the conditions under which they gave their consent change dramatically while the contract itself provides no provision for such contingencies. Ultimately, the central question is whether a contract is still binding under dramatically changed circumstances. Failure to procure specific client consent characterizes the contracting problem of defeasance in the tax return offshoring setting and is situated in the bottom left hand corner of the Oosterhout et al. (2006) model (See Figure 1). At the time of entering into the contract for preparation of tax returns, the client has an expectation that the return will be prepared by or under the direct supervision of the AICPA member. The terms under which consent was given change dramatically when returns are offshored. Procuring specific client consent would diminish the defeasance problem. However, it may also reduce the effectiveness with which services may be rendered, lowering the likelihood of the client returning to the same CPA firm the following year for tax return preparation. Consequently, the AICPA member will favor the disclosure strategy that conceals information about the offshoring of returns over a strategy that discloses offshoring of returns.

Concealing Privately Held Information

Reciprocity is also threatened by calculated efforts of some contracting parties to mislead or confuse others (Williamson, 1985). Contractors are vulnerable to partner opportunism as a consequence of ex ante information problems (Akerlof, 1970), a form of information asymmetry whereby one party is better informed about its own motivations and qualifications than other contractors. The term deception is used to denote the contracting problems whereby all deliberate efforts to mislead contracting partners are made before they commit themselves to a binding agreement. The AICPA Code requirements may enable a member to conceal clues that would make it evident to the client that the terms of the engagement have been altered. The AICPA member's attempt to mislead clients is revealed by their reluctance to disclose information about the specific location of the service provider.

By concealing information about the risks faced by the clients and equating outsourcing domestically to offshoring, the AICPA members may be making a deliberate attempt to mislead their clients before engaging in a binding agreement with them. Instead, proper disclosure requirements should provide taxpayers information about how exactly the return will be prepared, enabling taxpayers to formally opt in to the use of a TPSP. For instance, the following is a suggested sample disclosure statement adopted from the case scenario of the experiment:

“The firm may share confidential information about you with these service providers but will remain committed to maintaining the confidentiality and security of your information. Further, the firm will maintain internal policies, procedures and safeguards to protect the confidentiality of your personal information and will enter into confidentiality agreements with all service providers to maintain the confidentiality of your information. In the event that the firm is unable to secure an appropriate confidentiality agreement, **you will be asked to provide your opt-in consent prior to the sharing of your confidential information with the third-party service provider.** Furthermore, the firm will remain responsible for the work provided by any such third-party service providers.”

Concealing privately held information characterizes the contracting problem of deception in the tax return offshoring setting and is situated in the upper right-hand corner of the Oosterhout et al. (2006) model (See Figure 1). The

problem of deception will be overcome if the AICPA reduces the dysfunctional ex ante information asymmetries so that the opportunity to exploit proprietary information does not result in abusing their commitment to their clients. Concealing privately held information is a factor instrumental in lowering the client's likelihood of returning to the same CPA firm the following year for tax return preparation, leading the AICPA member to adopt a disclosure strategy that conceals information regarding the offshoring of return preparation over a strategy of full disclosure.

The above discussion described how the three contracting problems combine to identify the motivations of AICPA members not to disclose offshoring information. The AICPA members want to maximize the taxpayer's likelihood of returning to the same firm the following year for tax return preparation because losing repeat customers will hurt their economic interests. The taxpayer's likelihood of returning is hypothesized to be a function of the disclosure strategy adopted by the AICPA member. The AICPA member will react favorably to a disclosure strategy that maximizes the likelihood of returning and will be averse to any disclosures that lower the likelihood of returning. The likelihood of returning is influenced by client's averseness to offshoring of tax returns. The more averse the client is to the practice of offshoring, the greater is the AICPA member's incentive to conceal privately held information about offshoring. Hypothesis 1 tests the main effect of the disclosure strategy factor on the likelihood of returning. Accordingly, the first hypothesis of this study is stated as follows:

Hypothesis 1: The likelihood that taxpayers will return to the CPA firm for tax return preparation is lower when there is disclosure that returns are being offshored than when there is disclosure of outsourcing in the AICPA format.

From the above, one can argue that if the returns were prepared in-house, the likelihood of the client returning to the firm the following year would be higher than if returns were outsourced or offshored. The disclosure strategy that discloses that returns are prepared in-house is a control condition thus facilitating a comparison of the client's response to outsourcing and offshoring of returns.

Hypothesis 1a: The likelihood that taxpayers will return to the CPA firm for tax return preparation is higher when returns are prepared in-house than when there is disclosure that returns are being offshored.

Hypothesis 1b: The likelihood that taxpayers will return to the CPA firm for tax return preparation is higher when returns are prepared in-house than when there is disclosure that returns are being outsourced.

3.2 Hypothesis 2: Taxpayer's response to firm pricing strategy

We appeal to Stigler's search theory of economic rationality in order to understand the taxpayer's behavior in response to pricing strategy. The taxpayers are sensitive to the disclosure strategy as well as changes in fees. Given the requisite information, the pricing strategy of the tax preparer will have a bearing on the taxpayer's likelihood of returning to the same firm in the following year. Fishman and Hagerty (2003) analyze a market in which all customers know whether information has been disclosed, but some customers lack the technical expertise necessary to interpret the information, therefore they are categorized as uninformed. This lack of expertise may be due to consumers having neither the time nor the education to become knowledgeable enough to understand the information. In their model, with uninformed customers who cannot observe product quality, pricing decisions of sellers are strategic as well (Fishman and Hagerty, 2003).

When price is better known than quality, consumers may use three choice strategies under uncertainty: best value, price-seeking, and price aversion (Gordon, 2005). Best value is choosing the brand with the least overall cost in terms of price and expected quality; price-seeking is choosing the highest priced brand to maximize expected quality; price aversion is choosing the lowest priced brand to minimize immediate costs. The three choice strategies arise from three different research paradigms: best value from the economic theory of rationality, price-seeking from research on inference, and price aversion from research on risk aversion. Rationality is a set of principles that describe the normatively best or utility maximizing choice.

Stigler (1961) is usually referred to as the first article in search theory of economic rationality. The typical case considered in search theory is described as follows. A consumer wants to buy a unit of a certain commodity. Clearly, he or she prefer to do so at the lowest available price in the market. Unfortunately, the consumer does not perceive all prices with certainty, and there are costs such as money, time, and disutility attached to actions that improve the perception of the transaction opportunities, i.e., searching for lower prices. Both the returns of search in the form of lower prices and the costs of search will also depend on the consumer's preferences. Economic behavior implies that a consumer does search, and thus

does change his or her perspective on their opportunities, as long as it is perceived to be advantageous to them. As a result, agents do not necessarily buy at the lowest price available in the market, but at the lowest price they perceive in their opportunity set, while better opportunities might be available ‘just around the corner’.

In this study, the behavior of the taxpayers in response to the firms’ pricing strategies is understood by appealing to the search theory of economic rationality (Stigler, 1961). A rational self-interest maximizing individual will favor lowest price available in the market given a set of opportunities. Thus, we hypothesize that a decrease in fee will be viewed favorably by taxpayers and will increase their propensity to return to the same firm for tax return preparation the following year in all three cases (outsourcing within the U.S., offshoring, and preparing returns in-house), relative to no change in fees. Thus, the likelihood of the client returning to the same firm the following year for tax return preparation will be influenced by the pricing strategy adopted by the AICPA member. Reduced fees may signal to the taxpayers that a portion of the cost savings is being passed on to them and may moderate the negative effect of the offshoring disclosure, making them less averse to offshoring. Accordingly, the second hypothesis of the study is stated as follows:

Hypothesis 2: The likelihood that the customer will return to the CPA firm for tax return preparation the following year is higher when the fee is decreased the following year than when there is no change.

3.3 Hypothesis 3: Interaction effect between pricing strategy and disclosure strategy

The specific nature of the interaction effect between pricing strategy variable and disclosure strategy variable, if any, will be examined by conducting post hoc analyses.

*Likelihood of Returning = Disclosure Strategy * Pricing Strategy * (Disclosure Strategy* Pricing Strategy)*

where the last term on the right hand side of the equation is the interaction term.

Accordingly, hypothesis 3 of the study can be stated as follows:

Hypothesis 3: Pricing strategy moderates the relationship between disclosure strategy and the likelihood that the customer will return to the CPA firm for tax preparation the following year.

4. Research Methods

This study utilizes an experimental methodology. The experiment focuses on likelihood judgments made by the taxpayers about returning to the same firm for tax return preparation. One reason for choosing a likelihood judgment task is to capture the reasoning embedded in the taxpayers’ response to the disclosure strategy and the pricing strategy adopted by the AICPA member. The results of the experiment will bring forth the concerns that taxpayers may have regarding outsourcing and offshoring of their tax returns and assess whether the current wording in the Code addresses those concerns. The disclosure strategy and pricing strategy are the independent variables while the dependent variable is the subject’s assessment of the likelihood of returning to the same firm the following year for tax return preparation.

Subjects

Subjects were recruited by students in four undergraduate accounting classes. These students were offered extra credit points for recruiting eligible participants, who may have been their parents, relatives, friends, co-workers, etc. An eligible participant was described as a “U.S. citizen over age 18 who has filed tax returns for at least two years.” The participants were seated in an auditorium and were given thirty minutes to complete the questionnaire. The total number of respondents recruited was 258. Ten of the respondents did not pass the manipulation check questions and were eliminated. 5 respondents were eliminated due to incomplete responses leaving a total of 243 respondents. Respondents were asked the following question: “Have you or a family member ever been terminated from a job because your employer outsourced your position to a TPSP.” An affirmative response to the question was presumed to signify the presence of personal prejudice towards outsourcing. Twenty-four respondents gave positive responses to this question and were subsequently eliminated, resulting in a final sample of 219 useable responses.

Instrument

The questionnaire required the subjects to make decisions about their likelihood of returning to the same CPA firm the following year for preparation of their tax returns, denoted as L(R), based on the pricing strategy and the type of disclosure given to them. The two pricing strategies and four disclosure strategies gave rise to eight versions of the questionnaire. The questionnaire was prepared in two parts, as provided in Appendix B.

Versions 1–4 included a price decrease of 20%, representing pricing strategy I. Versions 5–8 did not include any discount on fees, representing pricing strategy II. Further, the case scenario in version 1 included a paragraph which is the disclosure format recommended by the AICPA when returns are outsourced to a TPSP (see Appendix B). The disclosure paragraph notes that the return may be outsourced to a TPSP but does not reveal the location of the TPSP. This disclosure language used in the case was adopted from a sample notification disclosure document released by the AICPA (AICPA, 2005b). This disclosure could lead respondents to assume that returns are outsourced or offshored or not outsourced at all. The use of ‘may’ informed them of possibility that returns may be outsourced but at the same time is not conclusive. Since the location of the TPSP is not mentioned, some respondents will make assumptions about whether returns are outsourced domestically or overseas. The response to disclosure strategy I (D1) in version 1 helped gauge the impact on clients of the AICPA recommended disclosure relative to the other forms of disclosure.

Respondents were then asked, “Please circle below the percentage that most adequately represents the probability that you would continue to retain the services of Mckinsey and Pullen LLP (hereafter M&P) to prepare your 20X6 tax return. Responses were recorded on a ten-point scale with 0% = definitely will not retain and 100% = definitely will retain. This question served as a dependent variable. The next question probed the reasons for their answer in the previous question. Respondents were asked to list the extent of importance that the fee decrease, confidentiality of data, and quality of tax returns prepared by the tax preparer had in making their decision. The responses were recorded on a 7-point Likert scale with 1 = not very important, and 7= very important. They were also asked to list any other reasons that may have influenced their decision-making. Version 2 was identical to version 1 with the exception it included the following statement: “The notice also stated that M&P uses the services of a third-party service provider located in India in serving your account.” This statement expressly states the location of the TPSP and is designed to capture the respondent’s reaction to disclosure that their return is being sent overseas and represents disclosure strategy II (D2). In version 3 this statement was substituted by the following statement: “The notice also stated that M&P uses the services of a third-party service provider located in the U.S. in serving your account.” This statement expressly mentions that the TPSP is located within the U.S. and intends to differentiate between the respondent’s reaction to the return being outsourced overseas versus being outsourced domestically and represents disclosure strategy III (D3). Version 4 was a control condition and expressly stated that returns were prepared in-house by the employees of M&P. This statement represents disclosure strategy IV (D4).

Part two of the experiment materials included a post experiment debriefing questionnaire and a demographic questionnaire. The post experiment debriefing questionnaire included questions that directly asked the respondent about their views regarding overseas outsourcing of their returns. They were asked if they believed that outsourcing of their returns would lower the quality of tax return preparation. Further, they were asked to express their agreement with the following statement: “Confidentiality of my personal data will be safe if I use a tax preparer who transfers my tax information, under his or her supervision, to a third-party provider located overseas for completion of my tax return.” Similarly, other questions asked if they agreed that the preparer should ask for their specific consent when using the services of a third-party provider and whether the preparer is behaving unethically when he or she sends their information, without the respondent’s knowledge, to a third party. Further, they were asked if they believed that the fees charged for the return should be decreased when returns are outsourced.

The demographic questionnaire included a question regarding the political ideology of the participant. Other questions explored whether the participant or any family member had been terminated from a job due to the employer outsourcing the position to a TPSP. This question was designed to detect and eliminate respondents that may hold biased views towards outsourcing due to personal prejudices thus skewing validity of the results. Level of patriotism was measured by recording participants’ responses using a CETSCALE (Shimp and Sharma, 1987). The CETSCALE is a psychometrically rigorous scale for measuring a concept called “consumer ethnocentrism.” “Consumer ethnocentrism” represents the beliefs held by American consumers about the appropriateness, indeed morality, of purchasing foreign-made products. From the perspective of ethnocentric consumers, purchasing imported products is wrong because, in their minds, it hurts the domestic economy, causes a loss of jobs, and is plainly unpatriotic. The participants’ attitude towards risk was also measured by using the risk scale component of the Jackson personality inventory measure.

The participant could not refer to part one while answering part two, and they were asked to answer part two only after they placed part one back into the envelope. This instruction was done to ensure that their initial responses would not be affected by the questions in the debriefing questionnaire. The eight versions of the case were arranged serially. An equal number of cases were prepared and distributed to ensure that each of the groups had equal sample sizes. The participants were assigned at random to a particular version.

5. Results

Demographics

Table 2 reports demographic information about the respondents. Forty-six percent of the respondents were female. Fifty-three percent of the sample had at least a high school degree, 35 percent had a bachelor degree, and 12 percent had graduate and other degrees. Fifty-six percent of the sample reported income under \$15,000, 30 percent earned between \$15,000 and \$50,000, and the remaining 14 percent reported income over \$50,000. Fifty-nine percent of the respondents associated themselves with a conservative political ideology and 69 percent responded as extremely patriotic. The risk aversion split for the respondents was 52 percent as risk averse and 48 percent as risk taking. [See Table 2, pg. 302]

Additionally, untabulated demographics data provides that the average age of the respondents was 25 and the average full time work experience was five years. Finally, we note that the average number of years that the respondents had been filing tax returns was seven years, and that 42 percent of respondents reported using a paid preparer for filing their tax return.

Analysis

A two-way ANOVA was used to examine H1 through H3. The ANOVA includes the following two factors: (1) disclosure strategy variable with four levels and (2) pricing strategy with two levels. The dependent variable is each individual's likelihood of returning score. The results of the ANOVA are presented in Table 3. [See Table 3, pg. 302]

Hypothesis 1 (H1) predicts that the likelihood that taxpayers will return to the CPA firm for tax return preparation is lower when there is disclosure that returns are being offshored than when there is disclosure of outsourcing in the AICPA format. Table 3 indicates that the disclosure strategy variable had a statistically significant main effect as there is a statistically significant difference among the means of the four disclosure strategy levels ($F(3, 211) = 17.894, p < 0.000$). As Table 4 indicates, the mean likelihood of returning ratio for disclosure strategy II (D2) (when subjects receive disclosure that their returns are outsourced to an overseas location) was 40.875 whereas the mean likelihood of returning ratio for disclosure strategy I, D1 (when subjects receive disclosure of outsourcing of their returns' in the AICPA recommended format) was 55.362. This result is consistent with H1, and therefore hypothesis 1 is supported. Post hoc comparisons for the disclosure strategy variable are presented in Table 5. These tests reveal that a significant difference ($p < 0.013$) exists between D1 and D2 suggesting that there is a significant difference in the client's reaction to information disclosed in the AICPA recommended format versus disclosure that clearly states that the returns are being outsourced overseas. [See Table 4 and 5, pg. 303]

Hypothesis 1a (H1a) predicts that clients will prefer to have their returns prepared in-house than by a TPSP that is located overseas. Table 4 indicates that the mean likelihood of returning ratio for disclosure strategy IV (D4) (when subjects receive disclosure that their returns are prepared in-house by employees of the firm) was 75.186 whereas the mean likelihood of returning ratio for D2 was 55.362. Table 5 shows that an examination of the post hoc tests indicates that a statistically significant difference ($p < 0.000$) exists between D4 and D2. This result is consistent with H1a, and therefore hypothesis H1a is supported.

Hypothesis 1b (H1b) predicts the clients will prefer to have their returns prepared in-house rather than being outsourced to a provider located within the U.S. Table 4 indicates that the mean likelihood of returning ratio for D4 which was 75.186 is significantly different from the mean likelihood of returning ratio for disclosure strategy III (D3) (when subjects receive disclosure that their returns are outsourced domestically) which was 53.613. This result is supported in Table 5 which reveals that a statistically significant difference ($p < 0.000$) exists between D4 and D3. This result is consistent with H1b, and therefore hypothesis H1b is supported.

Hypothesis 2 (H2) predicts that the likelihood of returning under decreased fees (pricing strategy I), would be significantly higher across all the levels of disclosure strategy than the likelihood of returning under no change in fees. However, Table 3 reveals that the pricing strategy variable does not have a significant main effect on client's likelihood of returning $F(1, 211) = .381, p = 0.538$. The mean likelihood of returning under pricing strategy I was 57.299 whereas the mean under pricing strategy II was 55.218. Thus, there was no statistically significant difference among the means of the two pricing strategy levels. These results are not consistent with H2. Therefore, H2 is not supported.

An interaction was predicted between the disclosure strategy levels and pricing strategy levels is predicted by Hypothesis 3 (H3). However, as indicated in Table 3, this interaction was not statistically significant $F(3, 211) = .766, p = 0.514$. Therefore, H3 is not supported. The findings from H2 and H3 likely show that taxpayers are not willing to take on the risk of their tax returns being outsourced or offshored even when they are given an incentive of reduced prices (Gorman, 2018). The taxpayers likely place more value on their private information being kept confidential than the benefit of reduced prices for their tax return.

Additional Analyses

Table 6 reports the results of the questions used to directly measure the respondents' attitudes towards concerns related to the outsourcing and offshoring of their tax returns. On average, respondents considered confidentiality of their data (mean 5.32, on a 7-point scale, where 1 = not very important and 7 = very important), and quality of the tax returns prepared by the TPSP (mean 5.96, on a 7 point scale, where 1 = not very important and 7 = very important), as important factors in making their decision to return to the same firm. Respondents believed that if their return was outsourced within the U.S. to a TPSP, the quality would be about the same (mean 2, where 1= lower quality, 2 = same quality and 3 = higher quality) whereas if it was outsourced overseas, quality would be lower (mean 1.51, where 1= lower quality, 2 = same quality and 3 = higher quality). [See Table 6, pg. 304]

The respondents displayed strong agreement with the statement that asked whether their specific consent should be secured before outsourcing their returns within the U.S. (mean 2.07, where 1 = strongly agree and 7 = strongly disagree), and whether the preparer is behaving unethically by not procuring the respondent's consent (mean 2.36, where 1 = strongly agree and 7 = strongly disagree). They displayed even stronger agreement with the statement that asked whether the respondent's specific consent should be secured before outsourcing their returns overseas (mean 1.96, where 1 = strongly agree and 7 = strongly disagree), and whether the preparer is behaving unethically by not procuring the respondent's consent (mean 2.11, where 1 = strongly agree and 7 = strongly disagree). They disagreed with the statements that asserted that confidentiality of their data would be safe if their returns are outsourced within the U.S. (mean 4.06, where 1 = strongly agree and 7 = strongly disagree) and even more so, if the returns were outsourced overseas (mean 5.06, where 1 = strongly agree and 7 = strongly disagree). Lastly, when asked if fees should be decreased when returns were outsourced within the U.S., they displayed moderate agreement (mean = 3.26, where 1 = strongly agree and 7 = strongly disagree), though they displayed stronger agreement for fee reduction when returns are outsourced overseas (mean 3.01, where 1 = strongly agree and 7 = strongly disagree).

To further investigate the reasons underlying the client's averseness to offshoring, we considered a respondent's level of patriotism, attitude towards risk, and political ideology. These factors may provide further insights into underlying factors that may explain aversion to offshoring. We employed an OLS regression to test if there is a causal relationship between patriotism, risk aversion, political ideology and likelihood of returning as a customer next year (See Table 7). The coefficient for patriotism is negative and statistically significant. The coefficient value is $-.401$ ($p = 0.004$), suggesting that the higher the level of patriotism, the lower will be the likelihood of returning next year. The risk aversion variable ($p = .480$) and political ideology variable ($p = .190$) were not statistically significant, suggesting that these factors did not impact the respondents' likelihood of returning the following year. [See Table 7, pg. 303]

6. Discussion and Conclusion

The findings and implications of this study have to be considered within the context of its strengths and limitations. Laboratory experiments have the potential for high internal validity due to the controlled environment within which the decision-making behavior can be studied (Rutledge and Karim, 1999). However, one must exercise caution in generalizing the results to other groups and situations. In experiments of this type, the case situations are simplified abstractions of real-world situations (Rutledge and Karim, 1999). Therefore, although due care was taken to ensure that all necessary and relevant information was included, the cases remain abstractions.

In addition, we acknowledge the limitation that our sample included some college students.³ Since students may exhibit lower incomes and likely have less complex returns, future research should consider replicating our experiment with individuals having higher incomes and more complicated returns.

³ Eligible participants may have been parents, relatives, friends, co-workers etc. of the "recruiting" students. Thus student-age participants were not excluded from the sample.

The AICPA revised and updated the Code in order to ensure that if the member intends to use the services of a TPSP, the client should be informed. The revisions do not say *must*, and do not differentiate between disclosures of outsourcing of tax returns within the U.S. versus offshoring to providers outside of the U.S. This change could be considered a significant area of concern because it leaves room for judgment and interpretation and there are ethical and economic considerations involved in offshoring of returns that are different from outsourcing returns within the U.S. The economic issue is whether the client makes different decisions once they find out that their returns are being offshored. If clients decide not to return to the CPA firm the following year, CPA firms would lose revenue. Therefore, the CPA firms have strong economic motivation to not disclose the location of the TPSP in order to retain their clientele. The ethical concern central to this issue is the CPAs' professional responsibility to their client. The pursuit of economic gains over public interest may endanger the credibility of the firm and damage the reputation of the entire professional body. The findings of this study confirm that the taxpayers are not indifferent between outsourcing and offshoring of their returns, as suggested by the AICPA Code, and would prefer disclosure in clear simple terms, unlike the disclosure format currently recommended by the AICPA.

This study uses a laboratory experiment to consider this conflict by examining the effect of various disclosure strategies and pricing strategies on the client's likelihood of returning to the same CPA firm the following year for tax return preparation. Three research hypotheses were developed and tested in a laboratory experiment. Four levels of disclosure strategies were manipulated to test for a main effect on client's likelihood of returning. Based on the first and second hypotheses, main effects for the disclosure strategy variable and pricing strategy variable were expected. Further, in conjunction with the third hypothesis, an interaction was predicted between disclosure strategy levels and pricing strategy levels. A statistically significant main effect was found for the disclosure strategy variable on the client's likelihood of returning. This result provides support for H1, H1a, and H1b suggesting that clients are sensitive to the kind of information that is provided to them and change their decisions based on the information provided.

The average likelihood of the client returning to the firm was significantly lower when there was disclosure that returns are being offshored (40.875) than when there is disclosure in the AICPA format which conceals the location of the TPSP (55.362). This result confirms the prediction made in this study that the AICPA disclosure is not adequate, is misleading and attempts to conceal valuable information. The AICPA members want to maximize the taxpayer's likelihood of returning to the same firm the following year for tax return preparation because losing repeat customers will hurt their economic interests. Thus, the AICPA member will react favorably to a disclosure strategy that maximizes the likelihood of returning and will be averse to any disclosures that lower the likelihood of returning. Moreover, the client's likelihood of returning under the AICPA disclosure format (55.362) is similar to the client's likelihood of returning under disclosure that returns were outsourced within the U.S. (53.613). This result suggests that clients are interpreting the AICPA disclosure as their returns are being outsourced within or outside the U.S. This interpretation would be a logical assumption since the AICPA disclosure does not reveal the location of the TPSP in any clear terms. H1a and H1b clearly bring forth the client's preference to have their return prepared in-house by employees of the CPA firm than have it outsourced to a TPSP within or outside the U.S.

The pricing strategy did not show to have a significant main effect on the likelihood of returning. H2 predicted that a decrease in fee will be viewed favorably by taxpayers and will increase the likelihood of returning to the same firm for tax return preparation the following year in all three cases (returns prepared in-house, outsourced within the U.S., and offshored outside the U.S.). Additionally, H3, which predicted an interaction effect between disclosure strategy levels and pricing strategy levels, was not supported. Such results likely point to the notion that taxpayers are not willing to take on the risk of their tax returns being outsourced or offshored even when incentivized through a reduced cost of return preparation (Gorman, 2018). Future research should examine whether there are other moderating factors such as personal characteristics and economic status of the taxpayers, complexity of the return, size of the taxation firm, and any security of data concerns, which might have an influence on the impact of disclosure and pricing strategies on this decision.

The most important implication from this study is that the level of disclosure can influence clients' decisions. However, the AICPA has failed to recognize the need for adequate disclosure and insist that current Code wording addresses the needs of the public. The results of this study suggest that the AICPA recommended disclosure format is incomplete and needs to be revised to include information about the location of the TPSP and maybe, even, include a requirement to procure the client's specific consent before outsourcing their returns. The study brings forth important public policy implications for protection of consumers who constitute the most vulnerable targets with regard to the detrimental effects of offshoring.

The findings of this study may further lead regulators to review the adequacy of the disclosure rules and may induce a call for changes.

Acknowledgements

We express gratitude and special thanks to Dr. Robin Roberts and Dr. John Sweeney for their valuable insight and helpful suggestions.

References

- Akerlof, G. (1970). The market for lemons: Qualitative uncertainty and the market mechanism. *Quarterly Journal of Economics*, 84: 488–500.
- American Institute of Certified Public Accountants (2005a). Background and Basis for Conclusions Outsourcing. Available at <https://us.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/BasisforConclusionsOutsourcing.pdf>
- American Institute of Certified Public Accountants (2005b). Professional Ethics Executive Committee Sample Client Disclosure Language for Outsourcing Rules. Available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/sample_disclosure_notification.pdf
- American Institute of Certified Public Accountants (2014). Code of Professional Conduct. Available at <https://pub.aicpa.org/codeofconduct/ethicsresources/et-cod.pdf>
- Bousquette, I., and Bhattacharyya, S. (2022). Ukraine's Booming Tech Outsourcing Sector at Risk After Russian Invasion. *The Wall Street Journal*. Retrieved from <https://www.wsj.com/articles/ukraines-booming-tech-outsourcing-sector-at-risk-after-russian-invasion-11645749755>
- Brody, R., Coulter, A., and Jewell, J. (2006). *The CPA Journal*, 76(9): 66–71.
- Calderon, T., McCoskey, M. G., and Onita, C. (2021). Toward a Protocol for Tax Data Security. *Journal of Forensic and Investigative Accounting*, 13(1): 139–158.
- Canning, M., O'Dwyer, B., and Boomsma, R. (2022). Managing the Offshoring of Audit Work: Spanning the Boundaries Between Onshore and Offshore Auditors. *AUDITING: A Journal of Practice and Theory*, 41(2): 57–91.
- Clifford, L., Grossman, A. M., Johnson, L. R., and Tervo, W. A. (2019). Factors that Affect CPAs' Personal Applications of Ethical Tax Standards to Ambiguous Positions. *Research on Professional Responsibility and Ethics in Accounting*, 22, 31–56.
- Didia, L. N., Mayse, A. L., and Randle, E. C. (2018). The Effects of Outsourcing and Offshoring of Independent Audit Procedures on Bank Loan Officers' Perceptions of Financial Statement Reliability and Loan Decisions. *Journal of Accounting and Finance*, 18(3): 2158–3625.
- Donaldson, T., and Dunfee, T. W. (1999). *Ties that bind: A social contracts approach to business ethics*. Boston: Harvard Business School Press.
- Fishman, M., and Hagerty, K. (2003). Mandatory Versus Voluntary Disclosure in Markets with Informed and Uninformed Customers. *Journal of Law, Economics and Organization*, 19(1): 45–63.
- Fogarty, T. J., Sellers, R. D., and Jones, D. (2021). Is Public Accounting Eating Its Seed Corn? An Assessment of The Outsourcing of Tax Work. *The North American Accounting Studies*, 4(1): 34–50.
- Gorman, M. (2018). Do You Know Who Is Preparing Your Tax Return? *Forbes*. Retrieved from <https://www.forbes.com/sites/megangorman/2018/10/20/do-you-know-who-is-preparing-your-tax-return/?sh=e4bb6e271c7a>
- Hageman, A. M., and Fisher, D. G. (2016). The influence of client attributes and organizational climate on tax professionals. *Research on Professional Responsibility and Ethics in Accounting*, 20: 31–66.
- Hampton, J. (1993). Contract and consent. In R. E. Goodin and P. Pettit (Eds.), *A companion to contemporary political philosophy*: 379–393. Malden, MA: Blackwell.
- Lombardo, Carly (2003). Outsourcing Tax Prep is In, In, In. *Accounting Technology*, 19 (4): 26–29.
- Lyubimov, A., Arnold, V., and Sutton, S. G. (2013). An examination of the legal liability associated with outsourcing and offshoring audit procedures. *Auditing: A Journal of Practice and Theory*, 32(2): 97–118.

- McGowan, J. R. (2020). Accountant's Advice in the Context of Midco Transactions: Do Larger Accounting Firms Give Better Tax Advice? *Journal of Forensic and Investigative Accounting*, 12(1): 66–85.
- McGee, R. (2005). Ethical issues in outsourcing accounting and tax Services. Presented at 17th Annual meeting of the International Academy of Business Disciplines, Pittsburgh, PA. April 7–10.
- Mintz, S. (2004). The ethical dilemmas of outsourcing. *The CPA Journal*, 74(3): 8–10.
- Nouri, H., and Lafond, C. A. (2012). Financial terrorists and the offshore outsourcing of tax return preparation. *International Journal of Critical Accounting*, 4(3): 272–282.
- Oosterhout, V., Pursey, P., Heugens, A., and Kaptein, M. (2006). The internal morality of contracting: Advancing the contractualist endeavor in business ethics. *Academy of Management Review*, 31(3): 521–539.
- Robertson, J., Stone, D., Niederwanger, L., Grocki, M., Martin, E., and Smith, E. (2004). The coming accounting revolution: offshore outsourcing of tax return preparation. *The CPA Journal*, 75(6): 54–58.
- Robertson, C. J., Lamin, A., and Livanis, G. (2010). Stakeholder perceptions of offshoring and outsourcing: The role of embedded issues. *Journal of Business Ethics*, 95(2): 167–189.
- Rule, C. (2019). Getting Taxpayers' Consent to Disclosure or Use Tax Return Information under IRC Section 7216. *The CPA Journal*. Retrieved from <https://www.cpajournal.com/2019/12/03/getting-taxpayers-consent-to-disclose-or-use-tax-return-information-under-irc-section-7216/>
- Shamis, G., Green, C., Sorensen, S., and Kyle, D. (2005). Outsourcing, Offshoring, Nearshoring: What to Do? *Journal of Accountancy*, 199(6), 57.
- Shimp, T., and Sharma, S. (1987). Consumer Ethnocentrism: Construction and Validation of the CETSCALE. *Journal of Marketing Research*, 24(3): 280–290.
- Simon, H. A. (1998). First published in 1945. *Administrative behavior* (3rd ed). New York: Free Press.
- Soled, J. (2005). Outsourcing tax return preparation and its implications. *The CPA Journal*, 75(3): 14–16.
- Stigler, G. (1961). The economics of information. *Journal of Political Economy*, 69(3): 213–225. Transparency International (2021). Corruption Perceptions Index. Retrieved from: <https://www.transparency.org/en/cpi/2021>
- Vihanto, M. (2003), Tax evasion and the psychology of the social contract. *Journal of Socio-Economics*, 32(2): 111–125.
- Williamson, O. E. (1985). *The economic institutions of capitalism: Firms, markets, relational contracting*. New York: Free Press.

Table 1: Likelihood Judgments (%)^a by Condition

		Disclosure Strategy (D)			
		Disclosure in AICPA recommended format	Disclosure that returns are outsourced to an overseas TPSP	Disclosure that returns are outsourced to a domestic TPSP	Disclosure that returns are prepared in-house
		(Returns are offshored)	(Returns are offshored)	(Returns are outsourced)	(Returns are not outsourced at all)
		(D1)	(D2)	(D3)	(D4)
Pricing (P) Strategy	Fee Decrease (P1)	Case 1 P1D1	Case 2 P1D2	Case 3 P1D3	Case 4 P1D4
	No Change (P2)	Case 5 P2D1	Case 6 P2D2	Case 7 P2D3	Case 8 P2D4

^a Assessment of the likelihood that the taxpayer will return to the same CPA firm the following year for tax return preparation.

Table 2: Demographic Data

Gender		Highest Degree acquired		Annual Income	
Males	119 (54%)	High School	116 (53%)	<15,000	122 (56%)
Females	100 (46%)	Undergraduate	76 (35%)	15,000 – 49,999	66 (30%)
		Graduate	22 (10%)	50,000 – 74,999	13 (6%)
		Other	5 (2%)	>75,000	18 (8%)
Political Ideology		Patriotism ^a		Risk Aversion ^a	
Conservative	130 (59%)	Extremely patriotic	153 (69%)	Risk averse	113 (52%)
Liberal	89 (41%)	Less patriotic	66 (31%)	Risk taking	106 (48%)

Notes: ^a Results converted from their respective scale.

Table 3: Two-Way Analysis of Variance Results for Client’s Likelihood of Returning to the Same CPA Firm the Following Year Tests of Between-Subjects Effects

Dependent Variable: Likelihood Scores (DV)

Source	Type III Sum of Squares	Df	Mean Square	F	Sig.	Partial Eta Squared	Noncent. Parameter	Observed Power(a)
Corrected Model	34843.405 ^(b)	7	4977.629	8.024	.000	.210	56.171	1.000
Intercept	691053.349	1	691053.349	1114.051	.000	.841	1114.051	1.000
DisclosureStrategyIV	33300.214	3	11100.071	17.894	.000	.203	53.683	1.000
PricingStrategyIV	236.315	1	236.315	.381	.538	.002	.381	.094
DisclosureStrategyIV * PricingStrategyIV	1425.179	3	475.060	.766	.514	.011	2.298	.213
Error	130884.677	211	620.307					
Total	856550.000	219						
Corrected Total	165728.082	218						

Notes: Dependent Variable is the likelihood score DV. Independent variable IV is the disclosure and pricing strategy.

^a Computed using alpha = .05. ^b R Squared = .210 (Adjusted R Squared = .184)

Table 4: Estimated Marginal Means for Disclosure Strategy Variable

Disclosure Strategy (IV)	Mean	Std. Error	95% Confidence Interval	
	Lower Bound	Upper Bound	Lower Bound	Upper Bound
D				
1	55.362	3.399	48.662	62.062
2	40.875	3.330	34.310	47.440
3	53.613	3.392	46.927	60.298
4	75.186	3.363	68.556	81.816

Notes: D represents the disclosure strategy as outlined in Table 1 for strategies 1 through 4.

Table 5: Multiple Comparisons (Post Hoc)

Dependent Variable: Likelihood Scores (DV)

	(I) Disclosure Strategy (IV)	(J) Disclosure Strategy (IV)	Mean	Std. Error	Sig.	95% Confidence Interval	
			Difference (I-J)			Lower Bound	Upper Bound
						Lower Bound	Upper Bound
Tukey HSD	D1	D2	14.57(*)	4.750	.013	2.27	26.87
		D3	2.04	4.793	.974	-10.38	14.45
		D4	-19.63(*)	4.771	.000	-31.98	-7.27
	D2	D1	-14.57(*)	4.750	.013	-26.87	-2.27
		D3	-12.53(*)	4.750	.044	-24.83	-.23
		D4	-34.20(*)	4.728	.000	-46.44	-21.95
	D3	D1	-2.04	4.793	.974	-14.45	10.38
		D2	12.53(*)	4.750	.044	.23	24.83
		D4	-21.66(*)	4.771	.000	-34.02	-9.31
	D4	D1	19.63(*)	4.771	.000	7.27	31.98
		D2	34.20(*)	4.728	.000	21.95	46.44
		D3	21.66(*)	4.771	.000	9.31	34.02

Notes: Dependent Variable is the likelihood score DV.

D represents the disclosure strategy as outlined in Table 1 for strategies 1 through 4. Based on observed means.

Table 7: OLS Regression Analysis for Patriotism, Risk Aversion, and Political Ideology

	Coefficients ^(a)					Collinearity Statistics	
	Unstandardized Coefficients		Standardized Coefficients	t-statistic	Sig.	B	Std. Error
	B	Std. Error	Beta	Tolerance	VIF		
(Constant)	50.933	14.587		3.492	.001		
Patriotism IV	-.924	.305	-.401	-3.033	.004	.926	1.080
Risk aversion IV	.513	.721	.091	.712	.480	.996	1.004
Political Ideology IV	3.513	2.644	.176	1.328	.190	.923	1.083

Notes: ^a Dependent Variable is the likelihood score DV.

Table 6: Direct Measures of Client’s Attitude Towards Outsourcing and Offshoring

Questions	Scale	D1P1	D2P1	D3P1	D4P1	D1P2	D2P2	D3P2	D4P2	Total
How important was the following factor in making your decision: Confidentiality of data	1-7	5.63	5.93	5.93	NA	5.00	4.38	5.08	NA	5.32
How important was the following factor in making your decision: Quality of tax returns prepared by TPSP	1-7	6.00	5.90	5.65	NA	5.84	6.32	6.04	NA	5.96
If a tax preparer uses the services of a TPSP located within the U.S., the quality of my tax returns will be lower, higher or same	1-3	2.16	2.07	2.00	2.00	2.04	1.81	1.85	2.11	2.00
If a tax preparer uses the services of a TPSP located overseas, the quality of my tax returns will be lower, higher or same	1-3	1.36	1.79	1.29	1.32	1.69	1.70	1.48	1.46	1.51
Confidentiality of my personal data will be safe if I use a TPSP who transfer my information, under his or her supervision, to a TPSP located in the U.S. for completion of my tax return	1-7	3.80	4.31	4.18	3.92	3.89	4.00	4.19	4.21	4.06
Confidentiality of my personal data will be safe if I use a TPSP who transfer my information, under his or her supervision, to a TPSP located overseas for completion of my tax return	1-7	5.12	4.79	5.21	5.38	4.89	5.37	4.70	5.00	5.06
If I use a tax-preparer to prepare my tax return, that preparer should ask for my specific consent when using the services of a third-party provider located in the U.S.	1-7	1.88	2.38	2.11	1.96	2.24	1.74	2.07	2.18	2.07
If I use a tax-preparer to prepare my tax return, that preparer should ask for my specific consent when using the services of a third party provider located overseas.	1-7	1.64	2.52	2.07	2.00	1.62	1.70	2.22	1.89	1.96
If I use a tax-preparer to prepare my tax return, that preparer is behaving unethically if the preparer sends my confidential information without my knowledge to a third-party provider located within the U.S.	1-7	2.48	2.66	2.25	2.35	2.03	2.26	2.41	2.43	2.36
If I use a tax-preparer to prepare my tax return, that preparer is behaving unethically if the preparer sends my confidential information without my knowledge to a third party provider located overseas.	1-7	2.08	2.72	2.18	2.12	1.52	1.81	2.22	2.21	2.11
If my tax return is outsourced to a provider located within the U.S., the fees for my return should decrease.	1-7	2.72	3.86	3.29	3.31	3.21	3.04	3.23	3.46	3.26
If my tax return is outsourced to a provider located overseas, the fees for my return should decrease.	1-7	2.16	3.31	3.18	3.27	3.31	2.93	2.92	3.04	3.01

Figure 1: Contracting Problems and Disclosure

		Behavioral Characteristics of ‘contractual man’	
		<i>Bounded Rationality</i>	<i>Opportunism</i>
Normative expectations of contractual schemes	<i>Reciprocity</i>	Identity matters Veiling the identity of the TPSP	Deception Concealing Privately held information
	<i>Effectiveness</i>	Defeasance Failure to procure specific client consent	Defection

Source: Adapted from Oosterhout et al. (2006)
 Note: Contracting problems identified by Oosterhout et al. (2006) are presented in the cells’ northwestern corner and contracting problems identified as existing in the AICPA member-client relationship are presented in their center in bold font.

Appendix A: Pertinent AICPA Code Sections (Effective December 15, 2014)⁴

Current Code Citation	Full Description of the Code Section
0.400.47 Definitions	<p>Third-party service provider. All of the following:</p> <p>a. An entity that the member does not control, individually or collectively with his or her firm or with members of his or her firm.</p> <p>b. An individual not employed by the member who assists the member in providing professional services to clients (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions). [Prior reference: paragraphs .224–.225 of ET section 191, .023–.024 of ET section 291, and .001–.002 of ET section 391]</p>
1.150.040 Use of a Third-Party Service Provider	<p>.01 When a <i>member</i> uses a <i>third-party service provider</i> to assist the <i>member</i> in providing <i>professional services</i>, <i>threats</i> to compliance with the “Integrity and Objectivity Rule” [1.100.001] may exist.</p> <p>.02 Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Therefore, before disclosing confidential client information to a third-party service provider, the member should inform the client, preferably in writing, that the member may use a third-party service provider. If the client objects to the member’s use of a third- party service provider, the member either should not use the third-party service provider to perform the professional services or should decline to perform the engagement.</p> <p>.03 A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services to the member (for example, record storage, software application hosting, or authorized e-file tax transmittal services).</p> <p>.04 Refer to the “Use of a Third-Party Service Provider” interpretation [1.300.040] of the “General Standards Rule” [1.300.001] and the “Disclosing Information to a Third-Party Service Provider” interpretation [1.700.040] of the “Confidential Client Information Rule” [1.700.001] for additional guidance. [Prior reference: paragraphs .224–.225 of ET section 191]</p>

⁴ Source: AICPA (2014)

1.300.040 Use of a Third-Party Service Provider (Interpretations Under the General Standards Rule)	<p>.01 A member who uses a third-party service provider to assist the member in providing professional services such as bookkeeping, tax preparation, or consulting or attest services, including related clerical or data entry functions, is required to comply with the “General Standards Rule” [1.300.001] and the “Compliance With Standards Rule” [1.310.001]. To accomplish this,</p> <p>a. before using a third-party service provider, the member should ensure that the third-party service provider has the required professional qualifications, technical skills, and other resources. Factors that can be helpful in evaluating a prospective third-party service provider include business, financial, and personal references from banks, other CPAs, and other customers of the third-party service provider; the third-party service provider’s professional reputation and recognition in the community; published materials (articles and books that he or she has authored); and the member’s personal evaluation of the third-party service provider.</p> <p>b. the member must adequately plan and supervise the third-party service provider’s professional services so that the member ensures that the services are performed with competence and due professional care. The member must also obtain sufficient relevant data to support the work product and comply with all technical standards applicable to the professional services.</p> <p>.02 The member’s responsibility for planning and supervising the third-party service provider’s work does not extend beyond the requirements of applicable professional standards, which may vary depending upon the nature of the member’s engagement.</p> <p>.03 Refer to the “Use of a Third-Party Service Provider” interpretation [1.150.040] of the “Integrity and Objectivity Rule” [1.100.001] and the “Disclosing Information to a Third-Party Service Provider” interpretation [1.700.040] of the “Confidential Client Information Rule” [1.700.001] for additional guidance. [Prior references: paragraphs .015–.016 and .023–.024 of ET section 291]</p> <p>A nonauthoritative basis-for-conclusion document summarizing considerations that were deemed significant in the development of this interpretation is available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsoutsourcing.pdf.</p>
---	--

<p>1.700.040 Disclosing Information to a Third-Party Service Provider (Interpretations Under the Confidential Client Information Rule)</p>	<p>.01 When a member uses a third-party service provider to assist the member in providing professional services, threats to compliance with the “Confidential Client Information Rule” [1.700.001] may exist.</p> <p>.02 Clients may not expect the member to use a third-party service provider to assist the member in providing the professional services. Therefore, before disclosing confidential client information to a third-party service provider, the member should do one of the following:</p> <ul style="list-style-type: none">a. Enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and provide reasonable assurance that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the third-party service provider’s controls and procedures to safeguard confidential client information.b. Obtain specific consent from the client before disclosing confidential client information to the third- party service provider. <p>.03 Refer to the “Use of a Third-Party Service Provider” interpretation [1.150.040] of the “Integrity and Objectivity Rule” [1.100.001] and the “Use of a Third-Party Service Provider” interpretation [1.300.040] of the “General Standards Rule” [1.300.001] for additional guidance. [Prior reference: paragraphs .001–.002 of ET section 391]</p> <p>A nonauthoritative basis-for-conclusions document that summarizes considerations that were deemed significant in the development of this interpretation is available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/basisforconclusionsoutsourcing.pdf.</p> <p>In addition, nonauthoritative sample client disclosure language that could be used to fulfill the requirement discussed in this interpretation is also available at https://us.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/sample_disclosure_notification.pdf.</p>
---	--

Appendix B: Questionnaire Details

Hypothetical case scenario:

Mckinsey and Pullen LLP (M&P) is one of United States' largest accounting firms offering a wide range of services such as audit, accounting services, tax return preparation, estate and financial planning. M&P serves clients from approximately 100 offices across the United States. You have been using the services of M&P LLP to prepare your tax returns for many years. Your adjusted gross income for the recent tax year, 20X6, was approximately \$170,000, including \$8,000 of investment income. You have approximately \$18,000 in itemized deductions.

The 20X5 tax returns were completed on a timely basis, and you were satisfied with the quality of the services rendered by M&P. In 20X5, M&P did not outsource tax return preparation, and all individual tax returns were completed in-house by company employees. M&P charges clients for their services based on the actual billable time spent on their jobs. Billable time includes all preparation work, consultations, research, phone calls, e-mails and a review of the tax preparer's work. In 20X5, M&P sent you an invoice for tax preparation fees and expenses in the amount of \$1,200.

In January 20X7, you receive a notice from M&P reminding you of the documentation needed from you in order to prepare your 20X6 return. The notice also states that since you are one of their long-term clients, in an attempt to demonstrate to you how much they value your business, you will receive a discount of 20% of the amount of the total tax return preparation fees that will be charged for the 20X6 tax returns.

Disclosure format recommended by the AICPA when returns are outsourced to a TPSP:

M&P may from time to time, and depending on the circumstances, use third-party service providers in serving your account. M&P may share confidential information about you with these service providers, but will remain committed to maintaining the confidentiality and security of your information. Further, M&P will maintain internal policies, procedures and safeguards to protect the confidentiality of your personal information and will enter into confidentiality agreements with all service providers to maintain the confidentiality of your information. M&P will take reasonable precautions to determine that they have appropriate procedures in place to prevent the unauthorized release of your confidential information to others. In the event that M&P is unable to secure an appropriate confidentiality agreement, you will be asked to provide your consent prior to the sharing of your confidential information with the third-party service provider. Furthermore, the firm will remain responsible for the work provided by any such third-party service providers.