

Do Financial Statement Users Care About Differences In Board Members' Source of Financial Expertise? Views of Financial Analysts

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In this study we report financial analysts' confidence in financial reporting contingent upon varying sources of financial expertise of the audit committee's designated financial expert. We find that these sophisticated users have more financial statement confidence when the designated financial expert's source of expertise is accounting-based rather than supervisory-based, as defined by the securities exchanges. We also find that rather than the mandated categorizations of source of expertise, analysts tend to view the designated financial expert's expertise along the lines of internally- or externally-derived; and report more financial statement confidence when the designated financial expert's source of expertise is externally-derived. Further, we find that among a choice of individuals with accounting-based and external-based sources of expertise, financial statement confidence is generally highest when the designated financial expert is a current accounting professor. The level of confidence provided by different expertise levels appear to be independent of the size of the company and the complexity of the accounting issues considered. Our findings appear to support those of prior research in that expertise on the board of directors and audit committee is an important component of the confidence placed in a firm's financial statements.

INTRODUCTION

Prior research suggests that the security markets are sensitive to the financial expertise of board members. For example, investigating the period prior to the enactment of the Sarbanes-Oxley Act of 2002 (SOX - U.S. Congress, 2002), Defond, et al. (2005) find that companies appointing audit committee members with accounting expertise experience positive abnormal market returns. In contrast, no market reaction is observed upon the appointment of those with non-accounting financial expertise. This positive market reaction is supported by the findings

that financial expertise of an audit committee member is associated with a reduced incidence of financial statement restatement (Abbott, et al., 2004), a reduced likelihood of material weaknesses in internal control reported during an auditor change (Krishnan, 2005), and with a reduced likelihood of earnings management (Bedard, et al., 2004). Consistent with the market's apparent ability to distinguish between accounting and non-accounting financial expertise, there appear to be differences in the "diligence" of audit committees dependent upon the source of their members' financial expertise. The presence of accounting expertise is found to be positively associated with meeting frequency, while non-accounting expertise is not (Raghunandan and Rama, 2007). This is important because the results of prior research also suggest that audit committee meeting frequency is associated with positive outcomes related to financial reporting (e.g., Abbott, et al., 2004). Thus, the extent and nature of directors' accounting expertise appears to influence users' confidence in financial statements.

Post-SOX, the securities market exchanges require that all audit committees have a designated financial expert; and that the name of that financial expert be disclosed. Although a much more stringent definition of financial expertise was initially proposed, the requirement of SOX described in Section 407 adopted by the Securities and Exchange Commission (SEC) closely follows the Blue Ribbon Committee (BRC) definition and states that financial expertise can be gained either by performing accounting or auditing or by supervising the accounting function (BRC, 1999). Accordingly, an individual may be designated as an audit committee's financial expert even if he or she never completed an accounting class or had direct responsibility for the preparation of financial statements.

Examining disclosures in the first year of the financial expert designation requirement under SOX, Carcello, et al. (2006) find that most designated financial experts do not have backgrounds in accounting or finance. Further, they find that in many instances the individuals' designated as financial experts would not have been so based upon the previous, more stringent definition of financial expertise.

We extend the research on the value of the financial expert designation by gathering sophisticated financial statement users' views on the perceived differences in financial statement confidence when the source of board members' financial expertise varies, and when the size and complexity of the company varies. We find that when given a choice, financial statement users have more financial statement confidence when the designated financial expert's source of expertise is accounting-based rather than supervisory-based. Classifying expertise in an alternative manner, financial statement users tend to place more confidence in expertise that is externally derived than derived from working within a company. Further, financial statement confidence is generally highest when the designated financial expert is a current accounting professor. The importance of accounting-based expertise on users' financial statements does not vary by a company's size or accounting complexity. Designated financial experts' accounting-based financial expertise appears important to all companies regardless of size and complexity.

These findings should be important to companies as they consider new board and audit committee member appointments and to regulators as they consider potential changes to rules regarding the financial expertise of audit committee members. Confidence in financial reporting is an issue that is important to all capital market participants.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

In response to the increasingly complex accounting issues facing audit committees, in 1999 the BRC recommended that all audit committees should include at least one member who is financially literate, defined as the ability to read and understand fundamental financial statements (BRC, 1999). Since the time of the BRC's recommendation, the complexity of accounting has arguably increased, and the SEC has expressed its views on the necessity of financial expertise to enable audit committees to discharge their responsibility for the oversight of the financial reporting function (SEC, 2003). Based on the requirements of SOX, the security market exchanges now require that all audit committees have a designated financial expert. However, according to the SEC's definition of financial expertise, the source of the designated expert's expertise may vary greatly. For example, while it is obvious that a CFO with a CPA designation meets the definition of a financial expert, it is less obvious that a CEO with a degree in marketing also meets the definition of a financial expert.

The designated expert's depth of understanding of the preparation of financial statements, generally accepted accounting principles, and systems of internal control would be expected to affect his or her ability to influence the reporting quality. Prior research generally confirms the association between accounting knowledge and quality of reporting. For example, Dhaliwal, et al. (2006), find a positive association between accrual quality and accounting-based expertise, but no association with finance- or supervisory-based expertise. Therefore, it follows that measures of financial statement confidence are likely to be highest when the source of the designated financial expert's expertise is accounting-based. More formally stated:

H1: Users' financial statement confidence will be greatest when the source of the designated financial expert's expertise is accounting-based.

The importance of accounting-based financial expertise may vary dependent upon a company's size and its accounting complexity. Larger, more complex companies likely benefit more from accounting expertise than smaller, less complex companies. For example, accounting expertise may be more important to financial statement users when a company is a member of the Fortune 500 and has a large number of derivative transactions than when a company has a market capitalization of less than \$75 million and has no derivative transactions. However, it is also likely that larger, more complex companies have sufficient resources to hire managers with the requisite amount of financial expertise, while smaller companies may be dependent on external or independent sources of financial expertise like external auditors and independent board members. Accordingly, our hypothesis regarding the impact of the interaction of the source of financial expertise and size and complexity on the users' financial statement confidence is stated in the null. Specifically:

H2: The difference in users' financial statement confidence, driven by the designated financial expert's source of expertise does not vary by company size or complexity.

Defond, et al. (2004) and Dhaliwal, et al. (2006) report that the market's perception of the value of the source of expertise, or the impact of the source of expertise on financial statement confidence is also dependent upon, or complementary to, a company's corporate governance structure (e.g., the size and independence of the board). As discussed below, our analyses hold constant other corporate governance measures in an attempt to isolate the effect of source of financial expertise on perceptions of measures of financial statement confidence.

METHODOLOGY

To test the hypotheses, we survey 33 financial analysts/supervisors employed by a U.S.-based investment banking firm using a instrument that requests subject background information and collects evaluations of three measures of financial statement confidence. We use both within- and between-subjects analyses as discussed subsequently.

Each participant is presented with one of four different scenarios (between-subjects comparisons). In two of the scenarios the company is described as being a member of the Fortune 500; in the other two scenarios the company is described as smaller, being classified as middle-market with a market capitalization of \$75 million. Alternating risk, in two scenarios the company is described as having complex accounting issues and in two scenarios the company is described as having routine accounting issues.

In each of the four scenarios participants are asked to separately evaluate three measures of financial statement confidence using a six-point Likert scale, a direct measure, the participant's confidence in financial reporting quality; and two indirect measures, the participant's confidence in the independence of the external auditor and their confidence in the quality of the internal audit function, given varying descriptions of the audit committee's designated financial expert (within-subjects comparisons).

The indirect measures of financial statement confidence are employed based on the theoretical suggestion that auditor independence influences audit quality and hence, financial reporting quality (e.g., DeAngelo, 1981), and on the perceptions of external auditors and directors that the existence of an internal audit function contributes positively to financial reporting quality (Goodwin and Seow, 2001).¹ Further, Felix, et al. (2001) find that the contribution of internal audit to the external audit is influenced by internal audit quality. The design of the study's methodology and hypothesized relationship between the study's constructs is graphically represented in Figure 1.

The possible sources of financial expertise are varied to represent accounting-based (auditor, CPA, CFO, and accounting professor) and supervisory-based (CEO) sources. To help minimize any order effects, the financial expert descriptions are varied among the four scenarios. A control "expert" that does not meet the SOX definition of a financial expert (VP Sales and Marketing) is included to assess whether the participants were attuned to issues explored in the exercise. The format of the choice of source of financial expertise is presented in Figure 2.

¹ Empirical evidence of the relationship between auditor independence (generally measured as the amount or percentage of non-audit fees) and financial reporting quality (generally measured as discretionary accruals, willingness to issue a going concern opinion, or restatements), is at best mixed. Most studies' results suggest that there is no relationship (e.g., Frankel, et al., 2002; Ashbaugh, et al., 2003; DeFond, et al., 2002; Kinney, et al., 2004). The relationship between quality of the internal audit function and financial reporting quality is largely unexplored.

Figure 1
THE HYPOTHESIZED RELATIONSHIP BETWEEN THE STUDY'S CONSTRUCTS

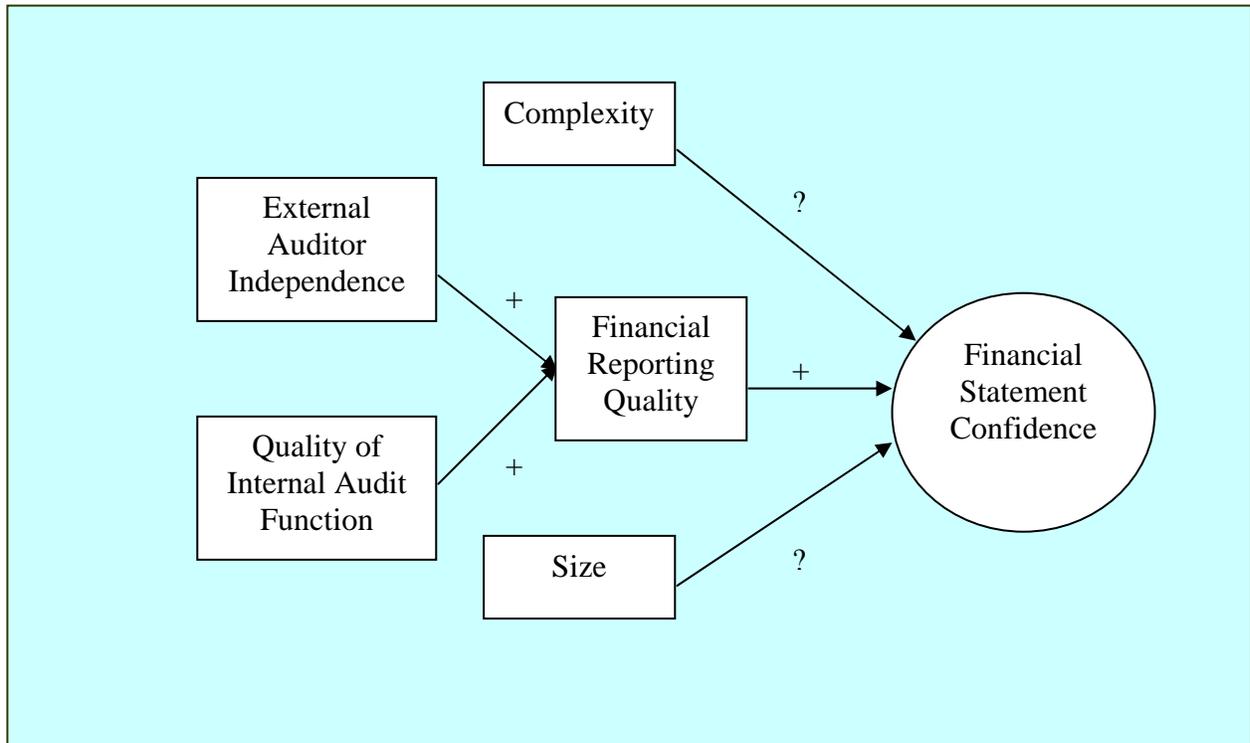


Figure 2
FORMET OF CHOICE OF SOURCE OF EXPERTISE

Please rate your confidence in Gamma Corporation's [one of three measures of financial statement confidence*] given that the designated Financial Expert has had no prior affiliation with Gamma Corporation and is a (note that these choices are not mutually exclusive. For example, an individual who was formerly a Big 4 auditor can also be a current CPA):**

	Not Very Confident				Very Confident	
Former Big 4 auditor	1	2	3	4	5	6
Current CPA	1	2	3	4	5	6
Current Accounting Professor	1	2	3	4	5	6
Current VP Sales & Marketing	1	2	3	4	5	6
Current CFO	1	2	3	4	5	6

Former CFO	1	2	3	4	5	6
Current CEO	1	2	3	4	5	6
Former CEO	1	2	3	4	5	6

* The three measures are: financial statement quality, independence of external auditor, and quality of the internal audit function.

**Note that these choices are varied in each of the three evaluations of financial statement confidence.

RESULTS

Of the 33 financial analysts surveyed, 32 returned completed, usable instruments included in the analyses that follow. The average age of the participants is 28.23 years. Eighty-one percent of the participants are male. On average, the participants have 5.35 years of experience. Approximately two-thirds hold bachelor's degrees and one-third hold master's degrees.

Table 1 presents descriptive statistics of the participants' responses to the study's questions about their financial statement confidence measures, given varying sources of a designated financial expert's source of expertise.

Table 1
DESCRIPTIVE STATISTICS
FINANCIAL STATEMENT CONFIDENCE (n = 32)

		Direct		Indirect				Aggregate Measure of Financial Statement Confidence
		Financial Reporting Quality		Independence of External Auditor		Quality of Internal Audit Function		
		Min – Max	Mean	Min – Max	Mean	Min – Max	Mean	
Accounting-based expertise	Current Accounting Professor	2 – 6	4.25	3 – 6	4.94	2 – 6	4.50	13.72
	Former Big 4 Auditor	2 – 6	4.44	2 – 6	4.19	2 – 6	4.47	13.09
	Current CPA	2 – 6	4.10	2 – 6	4.22	2 – 6	4.38	12.75
	Current CFO	1 – 6	4.09	1 – 6	3.34	2 – 6	4.06	11.50
	Former CFO	2 – 6	4.03	1 – 6	3.58	2 – 6	3.84	11.45
	Supervisory-based expertise	Former CEO	2- 6	3.22	1 – 5	3.34	2 – 5	3.31
	Current CEO	1 – 6	3.16	1 – 5	2.91	2 – 5	3.37	9.44
Not meeting the definition of a financial expert	Current VP Sales & Marketing	1 – 5	2.13	1 – 5	2.63	1 – 4	2.41	7.12

As depicted, there appear to be differences in the participants' reported financial statement confidence measures dependent upon whether a designated financial expert's source of expertise is accounting-based or supervisory-based. Further, as expected, participants' evaluated the choice of financial expert not meeting the definition of a financial expert (Current VP of Sales and Marketing), the lowest in terms of their financial statement confidence. As an additional test, we factor analyze participants' responses to determine whether their views of the source of financial expertise coincide with the categories defined by SOX and the securities exchanges (i.e., accounting-based expertise, supervisory-based expertise, no financial expertise). Contrary to expectations, our loadings do not map to the SOX and securities exchanges categories. Results provided in Table 2 suggest that participant responses do load into three distinct factors, but their classification appears to be along the lines of external sources of expertise, internal sources of expertise, and no expertise. Note that the number of observations used in factor analysis is 96 representing each participant's (n = 32) three separate evaluations of each choice of financial statement expert.

Table 2
FACTOR ANALYSIS: SOURCE OF EXPERTISE
COMPONENT MATRIX (n = 96)

	Component*		
	1	2	3
Former CFO	.841	-.185	-.394
Former CEO	.838	-.256	.014
Current CFO	.818	-.290	-.279
Current CEO	.739	-.450	.298
Current Accounting Professor	.314	.837	.105
Current CPA	.471	.824	.124
Former Big 4 Auditor	.537	.568	-.319
Current VP Sales & Marketing	.509	-.032	.802
Eigenvalue (% of Variance Explained)	3.491 (43.643)	2.089 (26.117)	1.094 (13.669)

*Extraction Method: Principal Component Analysis.

CFO- and CEO-based sources of financial expertise load on a single factor representing internally-based expertise. Professor-based and CPA-based sources of financial expertise load on a single factor representing externally-based expertise. Former Big 4 source-based expertise appears to be viewed as a combination of internal and external financial expertise as it loads on both of these factors, but not highly on either; and as expected, Sales and Marketing-based expertise loads on a separate factor. Based on this finding, our subsequent analyses consider both the mandated categorical descriptions of source of financial expertise from SOX and the securities exchanges as well as these endogenously-determined categories from the factor analysis.

Means across the direct and indirect measures of financial statement confidence presented in Table 1 appear to be similar. To determine whether we may aggregate the three measures into one measure of financial statement confidence in subsequent analyses, we compare the

means of each of the three measures, summarized based on the source of financial expertise to detect any significant differences.

Table 3
FINANCIAL STATEMENT CONFIDENCE ACROSS SOURCE OF EXPERTISE
COMPARISON OF MEASURES (n = 32)

Panel A: Classifications based on mandated definitions

	Direct	Indirect		Comparison of Means (p-value*)
	Financial Reporting Quality	Independence of External Auditor	Quality of Internal Audit Function	
Accounting-based expertise	4.19	4.05		>.10
	4.19		4.19	>.10
		4.05	4.19	>.10
Supervisory-based expertise	3.19	3.12		>.10
	3.19		3.34	>.10
		3.12	3.34	>.10
Not meeting the definition of a financial expert	2.13	2.63		.03
	2.13		2.41	.04
		2.63	2.41	>.10

Panel B: Classifications based on factor analysis (endogenously determined)

	Direct	Indirect		Comparison of Means (p-value*)
	Financial Reporting Quality	Independence of External Auditor	Quality of Internal Audit Function	
Internal-based expertise	3.64	3.29		>.10
	3.64		3.65	>.10
		3.29	3.65	>.10
Eternal-based Expertise	4.28	4.45		>.10
	4.28		4.45	>.10
		4.45	4.45	>.10
Not meeting the definition of a financial expert	2.13	2.63		.03
	2.13		2.41	.04
		2.63	2.41	>.10

* Two-tailed

Results presented in Table 3 suggest that using either the mandated categories of source of financial expertise (Panel A) or the factor-analyzed endogenously-determined categories (Panel B), there is a statistical difference in the measures of users' financial statement confidence only using the control definition of "expert" (i.e., when designated financial experts do not meet the definition of having financial expertise). Factor analysis presented in Table 4 using the factor analyzed categories of source of expertise (Panel B) confirms these findings; but results are mixed using the mandated categories of source of expertise (Panel A). Using the mandated categories, participants appear to view our three measures of financial statement confidence as three separate constructs. These findings are consistent with our observations that participants view designated financial experts' source of expertise more as internal- versus external-based (endogenously determined), than as accounting- versus supervisory-based (determined by mandate).

Table 4
FACTOR ANALYSIS: MEASURES OF FINANCIAL CONFIDENCE
ROTATED COMPONENT MATRIX (n = 96)

Panel A: Classifications based on mandated definitions

		Component* ^a		
		1	2	3
Accounting-based expertise	Financial Reporting Quality	.881	.224	.087
	Independence of External Auditor	.567	-.168	.593
	Quality of Internal Audit Function	.935	.032	-.143
Supervisory-based expertise	Financial Reporting Quality	.405	.583	.479
	Independence of External Auditor	-.034	.054	.900
	Quality of Internal Audit Function	.768	.250	.215
Not meeting the definition of a financial expert	Financial Reporting Quality	.271	.903	.092
	Independence of External Auditor	.033	.460	.635
	Quality of Internal Audit Function	.007	.922	.033
Eigenvalue (% of Variance Explained)		2.801 (31.123)	2.363 (26.252)	1.877 (20.855)

Panel B: Classifications based on factor analysis (endogenously determined)

		Component* ^b		
		1	2	3
External-based expertise	Financial Reporting Quality	.922	.175	-.014
	Independence of External Auditor	.696	.006	.203
	Quality of Internal Audit Function	.918	.050	-.018
Internal-based expertise	Financial Reporting Quality	.259	.412	.781
	Independence of External Auditor	.259	.412	.781
	Quality of Internal Audit Function	-.255	.038	.862
Not meeting the definition of a financial expert	Financial Reporting Quality	-.027	.603	.347
	Independence of External Auditor	.212	.880	.166
	Quality of Internal Audit Function	.030	.945	-.064
Eigenvalue (% of Variance Explained)		2.486 (27.621)	2.239 (24.874)	2.141 (23.790)

*Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.
a Rotation converged in five iterations.
b Rotation converged in four iterations.

Based on these analyses we continue to examine differences in both the individual direct and indirect measures of financial reporting confidence, as well as an aggregate measure. As each of the scores of the three measures of financial reporting confidence can range from one to six, the potential aggregate financial statement confidence scores range from three to eighteen. We also continue to explore categorical differences in the classification of source of financial expertise.

As presented in Panel A of Table 5 and consistent with Hypothesis 1, participant scores differ significantly based on whether the source of the financial expert’s financial expertise is accounting-based, supervisory-based, or does not meet the definition of a financial expert (p-values range from <.001 to .020). Accounting-based expertise provides users significantly more confidence than supervisory-based expertise and both provide significantly more financial statement confidence than an “expert” not meeting the SOX definition.

These results are consistent using the alternative factor analyzed classifications of source of expertise (p-values range from <.001 to .003). External-based expertise provides significantly more confidence than internal-based expertise and both provide significantly more financial statement confidence than an “expert” not having financial expertise.

Table 5
SOURCE OF EXPERTISE
COMPARISON OF MEANS (n = 32)

Panel A: Classifications based on mandated definitions

	Mean			Comparison of Means (p-value*)
	Accounting-based expertise	Supervisory-based expertise	Not meeting the definition of a financial expert	
Financial reporting quality	4.19	3.23		<.001
	4.19		2.13	<.001
		3.23	2.13	<.001
Independence of external auditor	4.05	3.12		<.001
	4.05		2.63	<.001
		3.12	2.63	.020
Quality of internal audit function	4.25	3.34		<.001
	4.25		2.41	<.001
		3.34	2.41	<.001
Aggregate measure of financial reporting confidence	12.44	9.77		<.001
	12.44		7.12	<.001
		9.77	7.12	<.001

Panel B: Classifications based on factor analysis (endogenously determined)

	Mean			Comparison of Means (p-value*)
	External-based expertise	Internal-based expertise	Not meeting the definition of a financial expert	
Financial reporting quality	4.28	3.64		.003
	4.28		2.13	<.001
		3.64	2.13	<.001
Independence of external auditor	4.45	3.29		<.001
	4.45		2.63	<.001
		3.29	2.63	.003
Quality of internal audit function	4.45	3.65		<.001
	4.45		2.41	<.001
		3.65	2.41	<.001
Aggregate measure of financial reporting confidence	13.09	10.62		<.001
	13.09		7.12	<.001
		10.62	7.12	<.001

* Two-tailed

We next test Hypothesis 2 by analyzing the impact of the designated financial expert’s source of financial expertise on participants’ aggregate measures of financial statement confidence, after controlling for a company’s size and complexity. In this analysis, we limit our comparisons to when the designated financial expert meets the qualifications of having financial expertise. That is, we omit from further testing the control definition that a designated financial “expert” does not meet the SOX criteria.

Table 6 presents an analysis of covariance which includes the main effects of the following variables and covariates:

Accounting-based expertise is a dichotomous variable equal to one if the designated financial expert’s expertise is accounting-based, and is otherwise equal to zero,

External-based expertise is a dichotomous variable equal to one if the designated financial expert’s expertise is externally-based and is otherwise equal to zero,

Fortune 500 company is a dichotomous variable equal to one if the experimental materials indicated that the company was a member of the Fortune 500 (as compared to other materials which indicated that the company was a middle market company), and is otherwise equal to zero, and

Complex accounting issues is a dichotomous variable equal to one if the experimental materials indicated that the company had a number of complex accounting issues (as compared to other materials which indicated that the company had no complex accounting issues), and is otherwise equal to zero.

Table 6
FINANCIAL STATEMENT CONFIDENCE
ANALYSIS OF COVARIANCE (n = 64)

Where:

The **dependent variable** is each participant's aggregate score of their confidence in financial statement confidence,

Accounting-based expertise is a dichotomous variable equal to one if the designated financial expert's expertise is accounting-based, and is otherwise equal to zero,

External-based expertise is a dichotomous variable equal to one if the designated financial expert's expertise is externally-based and is otherwise equal to zero,

Fortune 500 company is a dichotomous variable equal to one if the experimental materials indicated that the company was a member of the Fortune 500 (as compared to other materials which indicated that the company was a middle market company), and is otherwise equal to zero, and

Complex accounting issues is a dichotomous variable equal to one if the experimental materials indicated that the company had a number of complex accounting issues (as compared to other materials which indicated that the company had no complex accounting issues), and is otherwise equal to zero.

Panel A: Classifications based on mandated definitions

Source	Sum of Squares	df	Mean Square	F	Sig.*
Intercept	2570.445	1	2570.445	603.097	<.001
Accounting-based expertise	131.819	1	131.819	30.928	<.001
Fortune 500 company	24.117	1	24.117	5.659	.021
Complex accounting issues	.743	1	.743	.174	.678
Interaction of Fortune 500 company and Complex accounting issues	1.438	1	1.438	.337	.564
Error	251.463	59	4.262		
Total	8291.522	64			
Corrected Total	418.288	63			

Adjusted R Squared = .358

Panel B: Classifications based on factor analysis (endogenously determined)

Source	Sum of Squares	df	Mean Square	F	Sig.*
Intercept	2733.890	1	2733.890	487.925	<.001
External-based expertise	104.670	1	104.670	18.681	<.001
Fortune 500 company	9.492	1	9.492	1.694	.198
Complex accounting issues	.314	1	.314	.056	.814
Interaction of Fortune 500 company and Complex accounting issues	.026	1	.026	.005	.946
Error	324.980	59	5.603		
Total	9404.715	64			
Corrected Total	446.357	63			

Adjusted R Squared = .222

* Two-tailed

Consistent with our prior analyses, accounting-based financial expertise and external-based expertise both significantly influence participants' financial statement confidence ($p < .001$), even after partitioning out the variance in confidence attributable to a company's size and complexity. We find that the size of the company significantly influences users' financial statement confidence using the mandated categories of source of financial expertise ($p < .05$), while accounting complexity does not ($p > .10$). Using the factor analyzed categories, neither size nor complexity are important determinants in participants' reported financial statement confidence ($p > .10$). Although size cannot be ruled out as a potential influential variable of users' financial statement confidence, our results suggest that its influence is reduced when designated financial experts' have expertise that is externally derived.

As a final analysis, we examine the influence of background differences of individuals with accounting-based expertise on users' financial statement confidence. Results of these analyses are presented in Table 7.

Table 7
PAIRED SAMPLES STATISTICS
TESTS OF MEANS (n = 32)

	Mean					Comparison of Means (p-value*)
	Current Accounting Professor	Former Big 4 Auditor	Current CPA	Current CFO	Former CFO	
Financial Statement Confidence	13.72	13.09				.253
	13.72		12.58			.006
	13.72			11.50		.004
	13.72				11.45	.002
		13.09	12.58			.400
		13.09		11.50		.015
		13.09			11.45	.012
			12.58	11.50		.077
			12.58		11.45	.083
				11.50	11.45	.926

* Two-tailed

Financial Statement Confidence is each participant's aggregate score of their confidence across the three confidence measures.

As depicted, users' financial statement confidence is significantly higher when financial experts' source of expertise is as a current accounting professor ($p < .01$), except when compared to a financial expert whose source of accounting expertise is as being a former Big 4 auditor ($p > .10$). Former Big 4 auditors inspire greater confidence than current and former CFOs ($p < .05$), but not significantly different from current CPAs ($p > .10$); and CPAs inspire marginally more confidence than current and former CFOs ($p < .10$). Users' financial statement confidence is not dependent upon whether the designated financial expert is a current or former CFO ($p > .10$).

CONCLUSIONS, LIMITATIONS, AND OPPORTUNITIES FOR FUTURE RESEARCH

Based on our survey of sophisticated users of financial statements (i.e., financial analysts of a national investment banking firm), we find that a designated financial expert's source of financial expertise is an important determinant in users' financial statement confidence even after considering the effects of a company's size and complexity. Confidence increases when designated financial experts have accounting-based expertise as opposed to supervisory-based expertise. We also find that sophisticated financial statement users tend to categorize the source of a designated financial expert's expertise as either internally-derived or externally-derived; and that they have the most financial statement confidence when the designated financial expert's source of expertise is externally-derived. This finding is important for at least two reasons. First, it suggests that financial statement users may view CFO's and others who derive their expertise from working within companies as having less independence or willingness to exert oversight over managers perhaps due to shared experiences or empathic

views. Second, it suggests that the mandated categories of source of expertise should potentially be revised or expanded to consider these perceptions of sophisticated users.

Consistent with users' reported views in the categorization of expertise, we also find that financial statement confidence is greatest when the financial expert's accounting-based expertise is as a current accounting professor, and is weakest when it is based upon being a current or former CFO. As previously suggested it may be that, given the choices provided in our survey, that the participants consider CFOs to be less independent; or it may be that the participants perceive current accounting professors as being more objective than practicing CPAs or current and former CFOs.

These findings are important as they suggest that the source of the designated financial expert's financial expertise may serve as a signal of financial statement quality. Companies may want to consider the study's results as they seek out new board members or make audit committee appointment and financial expert designations. Regulators may also want to consider the study's results in the development of future regulation, particularly as they relate to the differences in perception of accounting- versus supervisory-based, and external- versus internal-based financial expertise.

It is important to note that the choices of the source of financial expertise provided in our experimental instrument are not mutually exclusive. Current accounting professors may also be current CPAs; former CFOs may be current CPAs; former Big 4 auditors may be current CEOs, etc. The effect of the interaction of these sources of financial expertise was beyond the scope of our study and should be considered for further investigation. We also did not consider the impact of the source of financial expertise under varying conditions of other corporate governance factors. Instead, our study attempted to hold these other factors constant. It may be that the size of the board or audit committee and meeting frequency, as examples, influence users' financial statement confidence given varying sources of the designated financial expert's financial expertise. This may be an area for future research.

Additionally, while our findings have statistical significance, they may or may not have economic significance. That is, our measures demonstrate differences, but how they equate to actual investment decisions has not been explored. However, finding significant results in spite of our limited sample size suggests that the effect size for our particular portion of the financial analyst population (i.e., financial analysts of a national investment banking firm) is large.

Finally, our findings are based on the perceptions of sophisticated financial statement users but may not be generalizable to all users. This possibility is somewhat mitigated given that analysts may exert a larger influence on the market than less sophisticated users, and based on the results of prior research which suggests that the market does reward companies based on board members' financial expertise (e.g., DeFond, et al., 2005).

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