

Accounting and enabling greater accountability: The suppressed role of the accounting intellect

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Draft: Please do not quote

The author would like to thank Professors Alan MacGregor and Markus Milne, University of Otago, two anonymous reviewers and the participants at the 4th International Accounting History Conference, 7-9 September 2005, Braga, Portugal, for their helpful comments on earlier versions of this paper.

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ABSTRACT

This paper extends the work of Weiss and Berney (2004), Clarke et al., (2003), Chambers (1980; 1999) and Schuetze, (2001) by developing the argument further that the current Generally Accepted Accounting Principles (GAAP) are a fundamental obstacle to producing reliable corporate information. Specifically, it is argued that the accounting profession may continue to evade *accountability* for corporate financial statements unless it responds to the intellectual issues in accounting. The paper shows that significant opportunities arose in the past - in the early part of the 1900s (during the aftermath of the US Securities Market Collapse), the debates of normative versus positive accounting (1930s – 1970s) and the audit expectations gap (1970s – 1990s) and finally during the aftermath of recent corporate collapses - for bringing intellectual solutions to accounting and auditing problems. However, instead of fulfilling its key obligations by introducing constructive solutions to the debated issues, the profession has continued to defend its abilities to serve the public interest and has promoted the notion of independence (again) as a means of both silencing its critics and arresting possible misrepresentations of corporate financial statements. Yet the real challenge is an intellectual one and the paper questions the ability of the accounting profession to control the intellectual aspects of its subject matter. Consequently, critics of accounting are likely to construe this failure as a clear signal of the inability of the profession to maintain control over its discipline. Addressing this challenge therefore is of paramount importance for convincing critics that the profession is, in fact, able to self-regulate its affairs.

INTRODUCTION

A brief review of the history of securities market problems and corporate failures shows that these failures are soon followed by stricter and more sophisticated legal measures (e.g., Securities Act of 1933 and Sarbanes-Oxley Act of 2002) than those that previously existed. As part of regulatory measures introduced in the 1930s – the Securities Act of 1933 - the audit itself received legal sanctioning in the U.S. (O'Connor, 2004). Accordingly, during the aftermath of the 1929 collapse of the U.S. securities market, the accounting profession gained legal recognition for *independent audits*, (O'Connor, 2004; Reiter and Williams, 2004) and hence became a part of the solution for corporate communication problems. In contrast, at the turn of the 21st century the accounting profession is now increasingly attracting the attention of critics as being part of the very problem the profession is supposed to resolve (Coffee, 2002; Simms and Oram, 2002; Weiss and Berney, 2004).

This change of positions for the accounting profession can have significant implications on the profession's ability to defend self-regulation of its affairs. For example, in recent responses, the regulators spared many areas where the accounting profession derives a significant amount of its power – e.g., mandatory audit requirements, the privilege to promulgate accounting standards, and more importantly, self-regulation. However, this may not be the case if regulators are to respond to another serious corporate scandal of the magnitude of Enron and World-Com. This is mainly because, there is little guarantee that, when regulators come under immense pressure from the public to punish the perpetrators of corporate

scandals, they will react only by introducing well-deliberated, reasonable, and sensible measures. Instead they may look for drastic, strong, and quick measures to appease the public and appear to be strong in the public eye. For example, as noted in O'Connor (2004, p.4; see also Ribstein, 2003, p.96), the history of legal responses to corporate problems shows that when responding to the issues about public trust, regulators often can be over-reactive:

“The Bubble Act actually may have precipitated the disastrous bursting of the South Sea Bubble, or it simply may have been concomitant with it. One commentator, however, has suggested that it was the first example, of a recurrent pattern of economic boom, bust and over-reactive regulation.”

Similarly, it is noteworthy that after the collapses of US corporate giants, US legislators took very little time to respond with a single piece of legislation - Sarbanes-Oxley Act of 2002 (hereinafter, SOX 2002). As some commentators note:

“... the wide-ranging act flew through the House of Representatives and Senate in record time and passed in both chambers by overwhelming majorities...“The era of low standards and false profits is over” Bush Proclaimed” (Bazerman, Lowenstein, and Moore, 2002, p.97).

However, since the passage of SOX 2002, many have raised questions about the likelihood of the regulatory protection that the act aims for becoming reality, given that it falls short of recommending critical measures essential to secure the credibility of corporate financial statements. For example, SOX 2002 failed to make it easier to take legal action against auditors and to remove conflicts of interests that compromise audit independence, etc., (Weiss and Berney, 2004, pp.45-46; Coffee, 2002; Conrad, 2004). Confirming these concerns, corporate executives too have indicated little confidence in SOX 2002:

“... only nine percent of executives surveyed in October 2002 characterized Sarbanes-Oxley as a good and adequate response to problems in accounting and reporting” (Weiss and Berney, 2004, p. 47).

During the last few years, many have taken SOX 2002 to task by highlighting its weaknesses and advocating alternative solutions (Bazermann et al., 2002; Coffee, 2002; Conrad, 2004; Eden, Ovadia, and Zuckerman, 2003; Leech, 2003; O'Connor, 2004; Weiss and Berney, 2004). These writers have debated issues brought up by Enron and other corporate collapses along with the potential solutions for these by drawing from wide-ranging areas of inquiry. For example, some have found support for their concerns from the psychology of decisions (e.g., Bazerman et al., 2002), philosophy (e.g., Reiter and Williams, 2004), corporate governance and history (e.g., O'Connor, 2004), sociology and economics (e.g., phenomenal increase in corporate compensation; Coffee, 2002), reasoning and logic (Eden et al., 2003), and communication and rhetoric (Conrad, 2004). Some commentators have attributed the blame squarely onto faulty accounting and auditing principles (e.g., Weiss and Berney, 2004). With the exception of this last study, it is of interest to note that there is little focus on accounting principles or issues arising from an ever-widening Generally Accepted Accounting Principles (GAAP), even though, arguably the current GAAP poses as serious an obstacle to enabling greater accountability for corporate financial statements, as does the issue of auditor independence.

The purpose of this paper is to extend the work of Weiss and Berney (2004) [and notable earlier work in this area, e.g., Clarke et al., (2003), Chambers (1980; 1999), and Schuetze, 2001] by developing the argument further that the current GAAP is a fundamental obstacle to producing reliable corporate information. Specifically, it is argued that the accounting profession may continue to evade *accountability* for corporate financial statements unless it responds to intellectual issues in accounting. This failure, if it continues, will be construed by critics of the profession as a clear signal about the profession's *inability* to "make ideological claims about serving the public interest" (Friedson, 1986, cited in Reiter and Williams, 2004, p. 357). For this purpose, firstly this paper reviews past accounting writings to show that the elevation of the status of accountants from bookkeepers to bankruptcy trusteeships and independent auditors in the mid 1800s to early 1900s was primarily a result of the State sanctioning the role of independent audits (and bankruptcy trusteeships) in the UK and US. Secondly, the paper shows that despite accepting a highly responsible position in society, the accounting profession has done little to develop a body of knowledge that is fitting for its practitioners more responsible roles as independent experts of corporate financial statements. For this purpose the works of several writers who, when the accounting profession was at crossroads in the past, attempted to rephrase the debate about 'reliable financial statements' as primarily an intellectual problem (e.g., Kenneth MacNeal; Raymond Chambers; Robert Sterling) are briefly reviewed. In the third section, drawing from previous work (Reiter and Williams, 2004; Sikka and Willmott, 1995) the paper explains how the accounting profession has primarily relied upon its claims about *independence* to silence its critics. Finally, the paper concludes by arguing that reliable corporate financial statements are unlikely to be a reality, along with greater accountability for these statements, unless the accounting profession fulfills the key intellectual obligations for its discipline.

FROM BOOKKEEPERS TO PROFESSIONALS

A brief look into the history of accounting in the UK shows that it is the company failures and the bankruptcy regulations that followed these failures (e.g., the Bankruptcy Act, 1869) that created initial opportunities for forming accounting organisations (Walker, 2004). For example, as stated in Napier and Noke (1992, p. 34, cited in Walker, 2004, p. 133), accounting in England received "its first professional boost" from the Bankruptcy Act of 1831. In his examination into the organisation of accountants in Liverpool, London, Manchester, and Sheffield during the aftermath of company failures and bankruptcy regulations, Walker (2004) shows that many studies recognised the importance of the Bankruptcy Act of 1869 (Boys, 1994; Walker, 1995; Markham-Lester, 1995) in understanding the professional organisations of accountants in the UK. Perhaps a main reason for the importance of this legislation is that the recognition of accountants' work as a specialist service in dealing with bankruptcy matters created significant economic opportunities for accountants (Stacey, 1954; Sikka and Willmott, 1995; Walker, 2004) and disturbed the jurisdictional boundaries of lawyers and accountants (Walker, 2004). For example, Walker (2004, p.134) writes:

"As well as being seen as a victory for the business classes and a reverse for lawyers, the Bankruptcy Act, 1869 was perceived as opening a wealth of opportunities for accountants in England."

Similarly, as stated in Sikka and Willmott (1995, p.551):

“In the U.K., the emergence of sellers of specialist labour who described themselves as “accountants” ...were initially stimulated by a buoyant demand for services in the area of bankruptcy, liquidation and trusteeship.”

The recognition of accountants as providers of specialist services created a tension between lawyers and accountants (Walker, 2004). According to Walker (2004), lawyers expressed concerns about the emerging jurisdictional dispute:

“During much of the 1860s the anxiety of lawyers about incursions into their professional jurisdiction centred on insolvency work” (Walker, 2004, p. 135).

With the increasing importance of bankruptcy related opportunities for accountants, a tension also grew about the possible competitions that would arise from less-reputable accountants. Accordingly Walker (2004) argues that the jurisdictional disputes that emerged during the aftermath of the Bankruptcy Act of 1869 involved not only inter-professional but also intra-professional disputes. Walker writes:

“The lawyers had to decide whether they would compete with accountants for the bankruptcy trusteeships. The Act also posed questions for established public accountants who were concerned about the prospect of an incursion by less respectable and uninstructed practitioners” (Walker, 2004, p. 137).

Similarly, lawyers themselves expressed concerns over possible competition between lawyers and accountants for the bankruptcy trusteeships. Walker (2004, p.138) states that:

“Would solicitors be prepared to suffer the indignity of competing for trusteeships, and associating themselves with debt collection, for the sake of capturing this work from accountants? The option remained of not demeaning themselves by competing for trusteeships and thereby leaving the field to ‘invaders’.”

In a similar vein, Sikka and Willmott (1995, p. 552) write:

“Sorting out company failures, for example, was deemed to be a peripheral, and not entirely respectable, line of work for upright, bone fide lawyers.”

Demand for these services along with a lack of competition from others for these and a growth in demand for finance capital further secured the importance of accounting work (Sikka and Willmott, 1995). Furthermore, Sikka and Willmott (1995) suggest that the recognition of the importance of accountants’ work in this area by company regulators secured a distinct place for accountants in society. They write:

“Accountants’ occupancy of areas of corporate regulation was consolidated by the Companies Act of 1862 which established the position of official liquidator to oversee the winding up of insolvent companies...” (Sikka and Willmott, 1995, p.552).

The Companies Act of 1862 also recognised other areas where accountants’ services would become essential for incorporated companies:

“... the 1862 Companies Act also required that dividends to shareholders be paid exclusively from income, a requirement that further boosted the demand for “respectable” accountants” (Sikka and Willmott, 1995, p. 552).

Thus, it is clear that during the 1860s and 1870s a strong need emerged for accountants to distinguish the ‘respectable’ from others as well as to negotiate jurisdictional boundaries for work with lawyers. According to Walker (2004) these provided the need for the formation of the Incorporated Society of Liverpool Accountants in 1870. As stated in Walker (2004, p. 141):

“The Incorporated Society of Liverpool Accountants was then, organised to achieve an accommodation with the local legal profession over the distribution of bankruptcy work ... to protect that market for those identified as leading accountants and to exclude the disreputable from practising the same profession.”

With the growth of limited liability companies that relied on raising capital from a wider group of people in society, the demand for services of accountants continued. The most important one of these services perhaps is the need for conducting independent audits. As noted in Sikka and Willmott (1995, p.553);

“...it was neither the state-carved niche of insolvency business, nor the formation of a professional body, but the steady increase in audit work that was to be the making of the modern U.K. accountancy profession.”

As discussed above, the prestige of the UK accountants was strengthened continually through the passages of legislation (e.g., Bankruptcy Act 1831; 1869; Companies Act 1862), which helped secure accountants’ ability to perform the audit function (Sikka and Willmott, 1995). Therefore, initially by capitalising on the opportunities presented to them by failing companies and subsequent company legislations (the Bankruptcy Acts of 1831 and 1869; the Companies Act of 1862) accountants managed to organise as a professional group; negotiated jurisdictional boundaries; and managed to distinguish the ‘respectable’ from others who could pose a threat for their market. As the need for independent examination of accounts arose, accountants perhaps were well positioned to convince others that only they were able to fulfil this role. For example, according to Sikka and Willmott (1995, p554) accountants have convinced others that:

“... only individuals trained and regulated by their own associations were fit to act as “independent” auditors” (Sikka and Willmott, 1995, p. 554).

The foregoing showed that during the mid 1800s accountants in England, by forming organisations, were able to make certain claims about the ability of the work of members of their organisations. However, it is somewhat unclear as to what provided a basis for their claims about independence¹. Reiter and Williams (2004) may shed light on this.

1. Similarly, as O’Connor (2004) explains, in the U.S., due to the inclusion of the mandatory certification requirement of accounts (as successfully lobbied for by the President of New York State Society of Certified Public Accountants) in the Securities Act of 1933, there was a substantial growth in the business and prestige of accountants (O’Connor, 2004). Like its counterpart in the UK, accountants in the US too offered one powerful justification for gaining the right to conduct audits – i.e., independence (O’Connor, 2004).

Following the work of Friedson (1994) they argue that professional organisations must be able to make some claims about public interest and these claims essentially are “elements of an ideology” (Friedson, 1994, p. 124, cited in Reiter and Williams, 2004, p. 357). Furthermore, according to Reiter and Williams (2004), an important ideological claim made by early accountants related to independence, which seemed to be based on the notion of “professional man” (Reiter and Williams, 2004, p. 357), which in turn relied on the moral character of Victorian ideals (Chandler and Edwards, 1996, cited in Reiter and Williams, 2004, p. 357). As discussed above, during the 1870s there was considerable pressure from lawyers to negotiate jurisdictional boundaries with ‘respectable’ accountants and both lawyers and accountants were also determined to *keep less reputable accountants* out of the market for bankruptcy work. Referring to a response to someone who sought the membership of the Institute of Accountants in London in 1875, Walker writes:

“This relatively minor episode illustrates the manner in which the emergent accountancy organisations in Britain constructed the ‘professional’ accountant as an independent, fee-earning altruist” (Walker, 200, p. 313).

Perhaps, these suggest that the notion of “professional man” was useful for accountants to make politically visible ideological claims about serving the public interest, including claims about independence. According to Reiter and Williams (2004, p. 358), the concept of independence under the notion of *professional man* essentially advocates “impartiality”, and hence, it can be argued that making such a claim is quite possible for *respectable* accountants who have distinguished themselves through organisation from their less reputable counterparts.

To sum up, in the mid 1800s to early 1900s, accountants raised their image from bookkeepers to professionals mainly by convincing others about their ability to deliver one important good – independence. This, however, left a rather important issue open for debate. That is, it was assumed that in so far as accountants maintained their independence when examining corporate financial statements, these would necessarily remain reliable. Stated differently, the ability of accounting to produce reliable financial reports was taken for granted. This issue is addressed in the next section.

ACCOUNTING INTELLECT

Accountants’ claims about independence in the 1900s and the acceptance of such claims by public as necessary for securing reliable corporate financial reporting imply that, as a body of knowledge, accounting had reached a stage where definite claims could be made about its ability to produce reliable corporate financial statements. This assumption, however, has attracted much criticism (see MacNeal, 1939; Chambers, 1966; 1980; Sterling, 1979; Schuetze, 2001). Describing the situation that existed after the 1929 crash, some commentators point out that the recognition of audits as a solution to financial statement misrepresentations led to a general neglect of the fact that many issues of accounting were still awaiting sound intellectual solutions (Seligman, 2003). Specifically, Seligman points out that:

“... the rapidity with which periodic audited financial statements became commonplace masked the continued unreliability of financial reporting” (Seligman, 2003, cited in O’Connor, 2004, p. 20).

For example, writings in the 1900s show that:

“... accountants’ reports provide ample evidence that accounting is not controlled by a body of principles which result in uniformity of procedure and treatment. There are several reasons for this condition. ... a principle is a fundamental truth, a fundamental law, or a fundamental assumption which forms the basis of reasoning or conduct; but many of the rules and procedures of accounting are not of so fundamental a nature” (Finney, 1924; 1946, p. 194, cited in Weiss and Berney, 2004, p. 33).

Therefore, what became a more important question than the issue of independence was then whether accounting could make claims about its products as being true representations of facts or opinions, or a mixture of both. Questioning accountants’ claims and the implications of these on the level of responsibilities they would be asked to bear, one commentator attempted to clarify accountants’ liability under the Securities Act of 1933:

“It has been said, and very rightly in my humble opinion, that accounting is after all a matter of opinion rather than anything else. But though this may be true I have still to see the case of a prospective investor being offered a balance sheet and having it carefully explained to him that this or that item is merely an opinion or deduction from a series of other opinions mixed in with a few acknowledged facts. ... Accountancy, as distinguished from law, has generally been portrayed as an exact science, and its representations have been proffered to the unlearned as representations of fact and not of opinion. If it insists upon such fact representations, it is, of course, fair that it should be burdened with the responsibility attendant upon such a portrayal of its results” (Landis, 1933, cited in O’Connor, 2004, p. 31).

These remarks show that accounting, despite being elevated to a highly prestigious profession in the early 1900s, had a considerable amount of work ahead of it, especially if it were to maintain some control over its claims about its ability to deliver reliable financial statements. Serious criticisms against its ability to make claims about the intellectual rigour of its subject matter therefore were unavoidable.

During the aftermath of 1929 collapse of the US securities market (MacNeal, 1939) and during the debate of price level adjusted accounting (Chambers, 1969; 1967; 1966; 1965; Sterling, 1970; 1977; 1979), the intellectual aspects of accounting problems attracted much attention. In his critique of the effectiveness of Securities regulation given the problematic nature of accounting principles, MacNeal argues that:

“The problem is intellectual, not moral. The accounting profession is not corrupt. Its individual members are, on the whole, as honorable as any group of men in the country, and they are faithfully following principles that have been expounded and developed by accounting authorities over many years. ... The real difficulty lies in the sophistry, illogic, and untruth of accounting principles which produce figures deceiving accountants, business men, and the public alike” (MacNeal, 1939, p. 18).

According to MacNeal, the accounting profession faced two alternatives in the 1930s for responding to the rising criticisms against its subject matter:

“On the one hand, accountants may admit that present accounting principles are based on expediency rather than on truth. They may acknowledge that these principles regularly cause balance sheets to exhibit meaningless figures and often cause profit and loss statements to be wholly misleading.

... On the other hand, accountants may refuse to revise present accounting principles and methods. Instead, they may choose slowly to redefine the purpose of accounting itself, as the pressure of criticism makes this necessary” (MacNeal, 1939, p.316).

Yet the profession chose the easier of the two alternatives (MacNeal, 1939). As he explains:

“... it is disheartening to note that accounting leadership, as apart from the great mass of accounting opinion, seems recently to have embarked on the second course outlined above” (MacNeal, 1939, p. 316).

Continuing to explain the possible lowering of the status of accounting, given the path it had chosen, MacNeal argues that:

“I believe it can also safely be said that this decline in prestige has been caused in large part by a growing realization on the part of the ordinary man that accounting does not talk his language, and that it is quite apt to deceive as to inform him. The tendency of the accounting profession to ignore the need for changing its methods does nothing to redeem its prestige. On the other hand, its tendency to seek an academic justification of present methods by redefining the accounting function can only end in its eventual admission that all accounting figures, whether for assets or income, are of little value. When this admission has been made, and has been comprehended by the public, accounting prestige will be at low ebb” MacNeal, 1939, p. 323).

In a similar vein, in the 1960s Chambers points out the disastrous consequences of the diversity of accounting. Specifically, Chambers shows that considering the number of alternative methods available when accounting for revenue, pension payment charges, taxes, depreciation, inventory, and miscellaneous issues; there would be numerous possible sets of methods:

“It should be clear that “generally accepted accounting principles” in respect of the items specifically considered above, countenance (a) 4, (b) 4, (c) 8, (d) 72, (e) 122, (f) 32, methods; or for any financial statements in which these may all occur – over 30 million possibilities!” (Chambers, 1969, p. 256).

Accordingly he argues that the readers of financial statements:

“... cannot know what precise set of methods has been used and cannot therefore know with what provisos he must accept any of the financial statements of different companies he may wish to consult at a given time to inform his choices” (Chambers, 1969, p. 256).

Why is there so much resistance to addressing these issues? Even after gaining recognition as a discipline that is worthy of university involvement, the meanings of many fundamental notions of accounting – including its most brave claims about *true and fair* financial statements - remain illusive.

In the 1970s, a prominent accounting academic offered some insights into this difficulty, highlighting the sociological issues embedded in accounting:

“In short, the lack of progress in agreement upon accounting principles and the lack of ability to institute accounting reforms cannot be explained on the grounds of logic. However, whenever we look at the progress of accounting in the context of power struggle, the explanation is obvious. The accountant could not reform a deficient theory because the dominant institution opposed that reform” (Sterling, 1977, p. 479).

For Sterling, the problem is one that involves the whole institution of audit arrangement and it dates back to the very beginning of the change in the role of accountant “from bookkeeper to independent auditor” (Sterling, 1977, p. 467). In his words:

“As an independent auditor, the accountant needed a strong defense against the always optimistic, sometimes dishonest, financiers and entrepreneurs. Unfortunately, he was not given this defense. Instead, he was placed in the precarious position of being the employee of the person he was obliged to keep honest. In the absence of a cohesive theory, in the absence of police power, in the presence of ignorance and apathy of the community, his only defense was precedent and persuasion. Precedent soon became rule and the rigid application of rules was his primary weapon. It is much easier and more diplomatic to accuse someone of breaking a rule than to accuse him of telling a lie” (Sterling, 1977, p.467).

After decades of his struggle to convince the accounting profession that it needs to develop a cohesive body of knowledge, (perhaps with which accountants may obtain the type of defence Sterling is alluding to) Chambers writes:

“... beneath all the impediment to advancement there lies a fallacy or a myth or both. That a systematic body of ideas can be developed by piecemeal attention to particulars is a fallacy. That the income statement is superior to the balance sheet is a myth. That there can be no set of rules, for the derivation of financial statements which can be applied uniformly to quite different ventures is a myth. That anomalies may be disregarded is a fallacy. That there is indeed a definable body of generally accepted accounting principles is a myth” (Chambers, 1980, p. 179).

As recently as 1999, Chambers re-visited the old issues and expressed his frustration as follows:

“Has it ever struck you as curious that, in the lengthy expositions of accounting concepts of standards boards and committees over the last forty years, and of textbooks over a much longer period, there is either no specification of what is meant by financial position or income? or, if there is, it is immediately disregarded?”

... Some forty years ago, as a member of a professional committee directed to clarify accounting terminology, I suggested that the exercise should begin with definitions of financial position and income; everything else should proceed from and be consistent with these definitions. My motion was denied on the ground that debate over decades had failed to reach agreement on these matters. And, since that time there is still no agreement” (Chambers, 1999, p. 121).

This inability of the accounting profession to maintain sufficient control over its ‘craft’ continued into the 21st century. Arguably, an unavoidable consequence of this failure was an ever-increasing list of rules. A former chief accountant to the SEC points out the present complexities of the US GAAP as follows:

“The rules for financial accounting and reporting in the U.S.A. have become vastly too voluminous, too detailed, too complex and too abstruse. ... The volume and complexity of those pronouncements have become overwhelming-on a par with the Internal Revenue Code and the related regulations in the U.S.A.” (Schuetze, 2001, p. 2).

More importantly, Schuetze (2001) provides a glimpse into the more serious undesirable consequences of the complexity of accounting, especially in making someone accountable for any misrepresentations in corporate financial statements. For example, he writes:

“While on staff at the Commission (SEC), I tried to explain relatively simple accounting issues and accounting rules to the Commission’s legal staff and its litigators, FBI agents, U.S. Postal Inspectors, and Assistant U. S. Attorneys in the Department of Justice so that they could bring and prosecute civil and criminal cases before administrative law judges, Federal judges, and juries. I had minimal success even on simple issues. The litigators and prosecutors are very reluctant to bring accounting fraud cases unless smoking guns are evident, such as, for example, fake invoices, boxes filled with bricks instead of laptop computers, or incriminating memos” (Schuetze, 2001, p. 3).

As can be seen, the concerns expressed in dated accounting writings appear to only become greater with the passage of time. Not surprisingly, currently serious questions about accounting and specifically its ability to maintain control over its intellectual sphere have been raised. Referring to an article published in the New York Times, Weiss and Berney provides a good example:

“Can accounting that follows the stated rules still be unreliable? ... After a year of corporate scandals in which some of the most outrageous financial reporting appears to have complied with generally accepted accounting principles, or GAAP, the answer appears to be yes” (Eichenwald, 2002, cited in Weiss and Berney, 2004, p 43).

In a similar vein, Coffee (2002, p. 1416 see also Mathewson and Roland, 2002) explains the nature of current accounting and its implications on reporting issues:

“Enron has shown that we have a “rule-based” system of accounting that arguably only asks the gatekeeper to certify the issuer’s compliance with an inventory of highly technical rules—without the auditor necessarily taking responsibility for the overall accuracy of the issuer’s statement of its financial position”

Explaining further the complexities of bringing in greater accountability for reliable financial statements by targeting individual members of the profession who perform audits, Coffee states:

“Even as a matter of theory, the gatekeeper’s services have value only if the gatekeeper is certifying compliance with a meaningful substantive standard. Yet, it is ... not within the power of the individual gatekeeper to determine that standard of measurement. In the case of auditors, organizational reform of the accounting firm thus will mean little without substantive reform of substantive accounting principles” (Coffee, 2002, p. 1417).

Serious concerns, somewhat along the same lines, were expressed during the 1980s, especially during the aftermath of serious financial scandals (e.g., BCCI). At the time, the profession emphasised the notion of audit expectation gap, which seemingly provides a legitimate excuse for failing to detect serious financial misrepresentations. According to Humphrey et al., (1993, p.395):

“The audit expectation gap has a long and persistent history.... The central issues incorporated within it (such as fraud detection, auditor independence, public interest reporting and the meaning of audit reports) have not only remained unresolved since the emergence of the term ‘audit expectations gap’ in the 1970s, but also have a history that is as long as that of company auditing itself” (see also Humphrey, et al., 1992).

In the sense of the above remark, many problems that stem from accounting intellect *inter alia* have been re-presented as part of a bigger issue – the audit expectation gap, leading to a search for solutions in mainly two ways. One is to educate the public about the many limitations of audits and the other is to make significant changes to

audit function so audits meet public expectations (Humphrey et al., 1992). According to some commentators the profession has taken a defensive approach to the issues surrounding audit expectations gap. For example, according to Humphrey et al., (1993, p. 396), the profession has attempted to discredit and down play the significance of the expectation gap or attribute this to an issue of individual auditors as opposed to a profession-wide problem:

“Concerns as to auditors’ performance have on various occasions been dismissed for their weak empirical basis, or as an over-exaggerated response to the isolated failings of individual auditors.”

Another commentator emphasises that the profession’s responses to the audit expectation gap was driven by self-interest motives. For example, Hooks (1992, p. 109) writes:

“All of the profession’s actions also maintain or strengthen the profession’s economic control of the market in which it sells its services.”

There are others who raise concerns about the expectations gap, especially whether this is indicative of some fundamental issues that may have serious implications for the profession. For example, referring to the various arguments emerging in the literature in the 1990s, Humphrey et al., (1993, p. 396; see also, Hopwood, 1990; Humphrey et al., 1991; 1992; Sikka, et al., 1992) state that:

“... a growing number of writers have begun to argue that the expectations gap is perhaps a consequence of the contradictions in a self-regulated audit system operating with minimal government intervention.”

The above remarks show that there are serious concerns about the profession’s willingness constructively, as opposed to defensively, to address fundamental issues.

Accordingly, it can be argued that whilst the audit independence issue has captured much attention in the aftermath of corporate collapses in the 2000s, currently a serious challenge to the authority of the profession is gaining momentum. Arguably, a significant part of this challenge is an intellectual one and it questions the ability of the accounting profession to control the intellectual aspects of its subject matter. For example, as stated in Allen (1991) a profession must be able to defend its control over intellectual aspects of its subject matter:

“A profession needs to “secure and maintain control over its work in the economic, political, social and *intellectual* spheres” (emphasis added) (Allen, 1991, p. 51, cited in Reiter and Williams, 2004, p. 356).

This poses a serious threat to maintaining the professional status of the accounting profession along with its ability to self-regulate. It is doubtful whether the profession can continue to ward-off increasing criticisms against it by resorting to the rhetoric of independence, by emphasising the significance of ethics, or by educating the public about the expectations gap.

PROFESSION'S CLAIMS ABOUT INDEPENDENCE

Arguably, by selecting the alternative MacNeal dubbed as the easier of the two, the profession initiated a path that would force it to continue searching for defences against its critics outside the profession's intellectual sphere. Viewed this way, whilst some reliance can be made on economics to silence the critics (e.g., citing higher costs for more thorough examination of financial statements), the profession's main defence seems to lie within the social and political spheres. An attempt to maintain certain ideological claims in social and political spheres, therefore, has become an essential part of this defence (Friedson, 1994; Reiter and Williams, 2004). In particular, here the accounting profession's claim for independence has become its primary ideological claim (Reiter and Williams, 2004; Sikka and Willmott, 1995). It is this claim to independence that the profession has used throughout its recent history in order to silence its critics who raise doubts about accountants' ability to facilitate the provision of reliable corporate financial information (O'Connor, 2004; Reiter and Williams, 2004).

Reiter and Williams (2004) explain the way the accounting profession presented its notion of independence, by characterising accountants as professionals. They write:

“The profession seeks to convince their public that auditors are independent *in fact*, even though they may not be independent *in appearance*. Independence in fact refers to the true state of objectivity of the auditor” (Reiter and Williams, 2004, p. 357).

The accounting profession's ability to distinguish independence *in fact* from *in appearance* has enabled it to defend its notion of independence – a state of mind - even when there are serious issues of conflicts of interest that cast doubt about the possibility of accountants' maintaining such independence (Reiter and Williams, 2004). Following the work of Friedson (1994), who views the basic characteristics of professions as mere ideological claims, Reiter and Williams state:

“This ideology is an important component of the process by which occupations gain and maintain control over valuable professional franchises. The character of the auditor as presented by accounting professional associations to the public and regulators is an important part of this ideological rhetoric” (Reiter and Williams, 2004, p. 357).

According to Reiter and Williams (2004), having established the premise that it is the independence *in fact* that accountants maintain, and this is *a state of mind* that can be maintained by its members, the accounting profession has continued to rely on certain ideals dominant in society from time to time to ward off criticisms against its claim about independence. As Reiter and Williams (2004) explain, the dominant ideals at the time, enabled the accounting profession to articulate different, yet powerful, conceptions of man that underlie its notion of independent state of mind. They describe, three conceptions – professional, judicial, and economic man - used to justify the claims of the profession about independence (Reiter and Williams, 2004). Whilst the notion of professional man relied on the moral character or Victorian ideals (Chandler and Edwards, 1996, cited in Reiter and Williams, 2004, p. 357), the conception of judicial man was based on “neutrality of thought that protects him from even unconscious bias” (Reiter and Williams, 2004, p. 361). However, the conception of economic man tends to depend entirely on “the power of economic incentives” for

maintaining objectivity (Reiter and Williams, 2004, p. 362; also Elliott and Jacobson, 1998).

The accounting profession has relied on the moral character of its members at the early stages of the profession (mid 1800s to early 1900s), and later has shifted its focus more to a judicial notion of man in the 1930s and then to a notion of economic man (mid 1900s) to argue for the possibility of the independent state of mind of auditors (Reiter and Williams, 2004). The continuing and changing nature of the rhetoric of independence is summed up in Reiter and Williams as follows:

“The self-interested character of “Economic Man” is very different from the character of “Judicial Man”, who was able to separate self interest from principled thinking, and different still from the “Professional Man” at the heart of early conceptions of independence in fact. However, in the post-Enron period, the profession has again begun to claim the character of “Professional Man” in hopes of restoring public confidence in the auditing profession” (Reiter and Williams, 2004, p. 364).

The profession’s attempt to shift the focus away from “economic man” and closer to “professional man” is understandable. This is because, the modelling of an auditor after a notion of economic man and its subsequent reliance on economic incentives for correcting auditor behaviour, has recently become highly questionable (Coffee, 2002; Conrad, 2004). For example, Coffee (2002) argues that auditors, along with other gatekeepers such as investment analysts, failed to raise alarms about financial mismanagement that contributed to the collapse of recent corporate giants mainly because incentives to support corporate management far outweighed those available for going against them.

“The pressure on gatekeepers to acquiesce in earnings management was not constant over time, but rather grew during the 1990s. In particular, during the 1990s, executive compensation shifted from being primarily cash based to being primarily equity based” (Coffee, 2002, p. 1413).

Accordingly, it is becoming clear that the recent corporate collapses along with the causes of these collapses have seriously undermined the power of the notion of “economic man” as a defence for independence. On the other hand, Conrad (2004, p. 5) shows that the real issues arising from the recent corporate collapses in the US have received little attention in the post-Enron debate, as policy makers have successfully narrowed the problems by emphasising the theory of ‘a few bad apples’. Narrowing the issues this way, the solutions have to be found by re-emphasising the importance of ethics, thereby increasing the acceptability of the notion of “professional man”.

ENABING GREATER ACCOUNTABILITY

As the discussion so far indicates, despite pleas for improving the discipline of accounting (e.g., MacNeal, 1939; Chambers, 1966; 1969; 1980; 1999), addressing the power disparity that exists between auditors and management (Sterling, 1977), and making constructive changes to reduce the audit expectations gap (Humphrey, et al., 1992; 1993) the profession has continued to fix its problems by defending its claims about independence, re-defining accounting and auditing problems as problems related to individuals as opposed to profession-related problems, highlighting the importance of ethics and more importantly introducing new rules. Whilst the

profession's claims about independence seem unconvincing, its rules (GAAP) attract criticisms as they arguably contribute towards *unreliable* financial statements (Weiss and Berney, 2004).

When considered in the light of the power disparity that exists between corporate management and auditors, it can be argued that the widening GAAP presents a problem that cannot be arrested solely by strengthening auditor independence. That is, given the multiplicity of accounting principles that come under the GAAP label, clients can select the treatments that help put their story in the best possible light without over-stepping GAAP, which nonetheless enables them to present financial statements unfairly. Thus, it is not surprising that recent work that draws from the psychology of judgements and decisions attempts to re-phrase the entire problem of auditor independence, and the lack of it, in terms of the presence of self-interest serving biases (Bazermann et al., 2002). For example, in challenging the adequacy of stricter legal remedies alone to arrest the problems of corporate financial misrepresentations some have argued that auditors are not necessarily corrupt but are unconsciously biased towards the preferences of their clients (Bazerman et al., 2002, p. 97). In particular, Bazerman et al., (2002) raise doubts about the effectiveness of legal remedies such as the ones introduced by the US Sarbanes-Oxley Act of 2002 as a means of improving corporate accountability. They write:

“...to attribute most errors to deliberate corruption would be to believe that the accounting profession is rife with crooks - a conclusion that anyone who has worked with accountants knows is untrue. The deeper more pernicious problem with corporate auditing, as it's currently practiced, is its vulnerability to unconscious bias. ...Unlike conscious corruption, unconscious bias cannot be deterred by threats of jail time” (Bazerman, et al., 2002, p. 97).

Even though these concerns are based on the recent findings of the psychology of decisions and judgements, in a sense they highlight a more fundamental problem of accounting. That is if biases are so widespread, these must be telling *inter alia* something about the flexibility of accounting treatments, which allow for different reporting of economic events and transactions even when these are similar.

At first sight, the above re-phrasing of the auditor independence issue appears to signal moral implications. As a result, the solutions to the problem have to be sought by addressing the issues of conflict of interest that make auditors vulnerable to self-serving biases. Consider, for example, the remark of some researchers who found that auditors are willing to acquiesce to clients' preferred accounting treatments:

“The independent auditor has an obligation to ensure that the particular accounting principles adopted are in his or her judgment the most appropriate under the circumstances, i.e., technical compliance with GAAP is necessary but not a sufficient condition to ensure the fair presentation of financial statements” (Shafer, et al., 2004, p.213).

If auditors are unconsciously biased towards clients' interests, then they will be unable to make fair judgements by balancing the interests of various parties affected by their judgements, let alone serve the public interest. Although this seems to follow that solutions must come via strengthening the auditor independence and improving auditors' moral commitment to their duties, it can be argued that neither of these can arrest the problems of financial statement misrepresentations fully. This is because corporate management is now in a position to present the story it wants to in financial statements whilst being in full compliance with GAAP. And, given that there is a lack

of cohesive knowledge with which to defend accounting choices, it is questionable whether there is a *single accounting treatment* that fairly represents the situation under any given circumstance. Attempts to explain the issues of auditing in terms of psychological biases seem to presume that the answer is affirmative. But, bias judgements are equally possible if auditors are to examine corporate affairs primarily from the perspective of shareholders. It is questionable whether erring in favour of shareholders as opposed to corporate management can fulfil the public interest, unless the public interest is construed in a very narrow sense.

On the contrary, it can be argued that if the accounting profession is to serve the interests of the public, then the profession's own rules about accounting – i.e., GAAP – should be guided by a higher objective such as the public interest and by this objective alone. Issuing accounting standards either on the basis of expediency or majority support for these is, however, unlikely to lead to this type of improvement in accounting. Furthermore, the promulgators of such rules ought to be able to defend the point that their prescriptions are suitable for meeting higher objectives, such as serving the public interest. This also involves revealing more information about accounting rule setting and shifting some accountability from those who apply existing rules (i.e., members of the profession) to the key decision makers in the accounting profession who create these in the first place. Therefore, any amount of effort to make objective decisions or in the moral development of those who execute the existing GAAP can be hardly adequate to enable greater accountability for misrepresentations in corporate financial statements.

CONCLUSION

This paper argues that the present GAAP is a significant threat to enabling greater accountability for corporate financial statements. The paper draws from previous writings to show that the current situation about accounting rules is mainly due to the failure of the accounting profession to fulfil its key obligations to the discipline. Furthermore, it demonstrates that, instead of fulfilling these obligations, the profession has continued to rely on and promote the notion of independence as a means of arresting possible misrepresentations of corporate financial statements. But the real challenge is an intellectual one and the paper questions the ability of the accounting profession to control the intellectual aspects of its subject matter. Consequently, critics of accounting are likely to construe this failure as a clear signal of the inability of the profession to maintain control over its discipline. Allowing such criticisms to grow will inevitably put pressure on the accounting profession to defend as to how and why accounting rules (just as the rules about taxation) cannot be made by politicians. Addressing this intellectual challenge therefore is important for convincing critics that the profession is, in fact, able to self-regulate its affairs.

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