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Legitimacy lost: Accounting’s predicament

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Title

Legitimacy lost: Accounting’s predicament

Abstract

The objectives and purpose of accounting theory as being promulgated by key global accounting regulators seem to downplay accounting’s stewardship function in favour of providing information to specific categories of user-groups. The Metatheoretical assumptions upon which modern-day accounting theory is based, especially seen against the ethical failures of recent corporate history and accounting’s role therein, raise several philosophical questions regarding the legitimacy of 21st century accountancy. In this article I will reflect upon on four key issues in respect of accounting theory, namely i) key ethical aspects, ii) a philosophical foundation, iii) the value concept and iv) decision-usefulness, as pertaining to the legitimacy of accounting in order to re-focus the paradigm context of the accounting sciences of the modern era.

Key words

Accounting theory, accounting philosophy, business ethics, value concept, decision-usefulness
Legitimacy lost: Accountancy’s predicament

1. Introduction

At the start of the 21st century, the accounting profession is faced with many pressures. These include corporate pressures to present the best possible operational and financial performances1 2, the global convergence efforts of accounting regulations3, not to mention the high profile media exposures of recent corporate scandals and accounting’s role therein4. A key objective of accounting is to facilitate the translation of a company’s operational performances into financial reports5 6. Modern companies, however, operate in an uncertain and complex business environment where they are under constant pressure to create value, while containing their costs and at the same time also adhering to many social responsibility requirements. Furthermore, the practice-driven focus of much in accounting education, the prescriptive role of non-university

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1 IFAC, The roles and domain of the professional accountant in business, IFAC, November 2005.
institutions in the content of the accounting syllabus\textsuperscript{7,8}, and the somewhat dictatorial accounting regulators promulgating their version of what should pass as accounting theory, often detract from the core objective of accounting. This, in turn, often results in not only the questioning of accounting information’s reliability and relevance, but also of accounting’s claim as being a \textit{scientific} discipline\textsuperscript{9}. The philosophy of science can be defined as the investigation of questions that arise from reflection upon science and scientific practice\textsuperscript{10,11}. The current state of the accounting discipline however, confronts us with quite a dilemma, especially when having to judge the usefulness of a philosophical approach within the context of accountants working in the modern business environment. Accounting academics often comment that because of the pace of developments in the profession, there is just no time for reflection on accounting.

Even though accounting scholars have long been trying to make accounting more scientific, this goal may be unachievable without overcoming the parochialism that dominates it\textsuperscript{12}. This narrowness of view is clear when considering the focus on accounting \textit{rules} and the emphasis on \textit{profit}, which may contribute to the low grasp of its place in the social sciences.

\begin{itemize}
\item \textsuperscript{7} Fellingham, J.C., Is accounting an academic discipline? \textit{Accounting Horizons}, 21(2)/June 2007, pp. 159-163.
\item \textsuperscript{8} Demski, J.S., Is accounting an academic discipline? \textit{Accounting Horizons}, 21(2)/June 2007, pp. 153-157.
\item \textsuperscript{11} Oxford Dictionary of Philosophy. Oxford: Oxford University Press. 1994, 408p
\item \textsuperscript{12} Mattesich, R., Accounting research and researchers of the nineteenth century and the beginning of the twentieth century: an international survey of authors, ideas and publications, \textit{Accounting, Business and Financial History}, July 2003, pp. 125–170.
\end{itemize}
2. Accounting context

As a point of departure, one needs to define accounting within the context of this article. As mentioned, accounting information can be seen as the financial translation of the results of the organisation’s performance. To put this “translation” in perspective, accounting refers to the work done in keeping financial records, while accountancy refers to the practice or profession of an accountant. Accounting, as a business application, encompasses two general branches. Firstly, financial accounting is the practice of preparing and reporting accounting information for parties outside the organisation. Secondly, management accounting has an internal user focus in support of management’s task in striving for the effective use of organisational resources. Furthermore, whereas the application of management accounting techniques is relatively non-standardised, financial accounting is subject to multiple accounting rules (or principles), which are encompassed in the so-called accounting standards, such as those of the IASB’s IFRS Statements or the FASB’s US GAAP. This article’s focus is perhaps more on the financial accounting aspect of accounting.

3. Methodology and problem definition

Considering the above, the question of whether modern-day accounting theory is a legitimate scientific discipline with a valid role to play in the social sciences comes to mind. Following initial research (and perhaps some general perceptions), this discussion’s hypothesis assumes that accounting is not a legitimate social science and as such it is likely to fail in providing valid support to the practical requirements of the modern business environment.

Some of the key Metatheoretical assumptions upon which current day accounting theory seems to be based, include the following:

- Accounting is considered a business performance measurement technique aiming to reflect some kind of reality;
- A fundamental objective of accounting is to achieve optimum utility for the users of accounting information; and
- Based on the rational behaviour of markets and individuals, financial models populated with accounting information have predictive abilities.

However, when considering these ‘accounting assumptions’ and the ‘accounting reality’, the ontological stance of this article is that there is something amiss in accounting epistemology. We therefore aim to challenge some of accounting’s Metatheoretical assumptions and to re-focus the paradigm perspective of what gets promulgated as accounting theory, and therefore also the paradigm of accounting education and research, in order to better reflect the true purpose of accounting and its function in the social sciences.

In light of this lacuna between these assumptions and the reality, it becomes important to identify and reflect on certain foundational accounting issues that may serve to the address the above question. The remaining discussion will therefore focus on the following four issues. Consideration is firstly given to some key ethical aspects related to the profession, secondly a philosophical foundation upon which accounting theory may be based, thirdly the concept of value in an accounting context and fourthly accounting’s
decision-usefulness objective as specified by global accounting regulators, after which a short concluding discussion will follow.

4. Legitimacy aspects under consideration

4.1. Ethical accounting conduct

The first issue to be considered is that of ethical accounting conduct. The question can be asked as to what some of the key ethical considerations in accounting are, and to what extent does it impact on accountancy.

Historically, accountancy was seen as fulfilling a stewardship function and even though key global regulators’ most recently stated accounting objectives seem to downplay this function, ethical conduct remains a crucial aspect of the discipline and many accounting institutes continue to require adherence to *codes of professional conduct*, which are typically based on the following pillars:

- **Integrity**, which requires unquestionable honesty, determination and sincerity;
- **Competency**, which requires adequate technical skills;
- **Objectivity**, which requires professional impartiality; and
- **Confidentiality**, which requires abstaining from using information obtained during the fulfilment of professional duties for personal gain.

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17 ICAEW, ICAEW Members’ handbook: Section 3: Code of ethics. [http://www.icaew.com/index.cfm/route/162804/icaew ga/Members/Member support/Professional conduct/Members handbook/3 2 Members handbook 2009/pd](http://www.icaew.com/index.cfm/route/162804/icaew ga/Members/Member support/Professional conduct/Members handbook/3 2 Members handbook 2009/pd). Date of access: July 25, 2009.
The aim of these codes of conduct is merely the provision of a framework of ethical accounting behaviour. The reality is that in the modern secular society, personal experiences and training are often more formative in the interpretation of this framework; not so much the historical influences of family and personal belief systems any more. When considering the above pillars of professional conduct individually, only integrity reflects directly on the human nature. As such, it may be argued that a lack in personal integrity may be a key contributing factor to failures in the other three pillars.

The concept of business ethics refers to the ethical values that determine the interaction between a company and its stakeholders. Ethical accountancy guidelines would therefore require an accountant to refrain from dealings that may damage the profession’s reputation, but also impacts on the individual accountant as well as all other related stakeholders. There are two discernable and basic ethical approaches namely formalism and consequentialism, the latter which includes utilitarianism\textsuperscript{18,19}. The concept of formalism is seen as the strict observance of form, or the adherence to rules and laws. In contrast, utilitarianism is a unique form of consequentialism in the sense of it being altruistic and based on the belief that the overall guiding principle of behaviour should aim to achieve the greatest happiness for the majority\textsuperscript{19}. Ethical accounting conduct as per the above pillars can therefore be seen as embracing both these extremes. On the one hand there are the \textit{behavioural directives} (formalism) that is embodied in the specific rules of the conduct codes, while on the other hand there are the \textit{behavioural commitments} (utilitarianism) that is embodied in the spirit of these conduct codes.


Therefore, in respect of the issue of ethical accounting conduct, it should be understood that basic principles, such as fairness, balance and consideration, must remain fundamental to accounting, and are essential in supporting the professional conduct requirements of integrity, competency, objectivity and confidentiality. It must also be remembered however, that even though an ethical code of conduct aims to meet the above principles, the human condition will in all likeliness always be tempted by its own weaknesses, and that no code of conduct will always be able to prevent the shortcomings in human nature.

4.2. Philosophical foundation of accounting

The second legitimacy issue to be considered is the ambiguity in grasping the primary purpose of accounting. The question can be asked whether it is possible to define a legitimate accounting philosophy.

Accounting theory is confronted with many relative values, which are to be reported in the various components of the financial statements. Financial reporting aims to provide information about an entity’s financial performance, of which the accounting system provides a recorded history. There are two basic schools of thought in accounting theory:

20 Sundem, G.L.
21 Damant, D.
- **Value school of thought**, which is based on how well accounting approximates the value of the wealth items\(^{21}^{22}\). The question remains however, as to what value actually means, let alone how to measure it.

- **Information school of thought**, which focusses on measuring and disclosing business events and the disclosure and communication of such information\(^{23}^{24}\). The multi-dimensional nature of business entities however, makes it difficult to evaluate effective information communication.

The modern business environment places big demands on accounting information to support business decision-making. Even though an important objective of accounting’s conceptual framework is to guide accounting practice, it also became the basis upon which the regulatory accounting bodies based their versions of accounting theory. This framework is significant in accounting, since it encompasses the conventions and rules that define the acceptable accounting practices of the time\(^{25}\), and any particular practice must have substantial authoritative support before it would be accepted as GAAP. Many scholars, however, have an issue with presenting accounting theory as a framework based on practices\(^{26}^{27}\).

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\(^{23}\) Sundem, G.L.

\(^{24}\) Schroeder, R.G., Clark, M.W. & Cathey, J.M.


\(^{26}\) Demski, J.S.

\(^{27}\) Fellingham, J.C.
We argue that a proper realisation of the purpose of accounting would be in its capability to support proper conclusions regarding the company’s performances. The ideal guide on which to formulate a legitimate accounting philosophy would acknowledge that accounting is a key component of all the economical aspects of a business entity and yet, while this entity is an integrated part of society, it remains an economic entity in its own right. In defining a fundamental accounting philosophy, there are three essential objectives to which basic accounting theory should point. Firstly, it must be acknowledge the fact that the primary purpose to be achieved by the recording and collecting of the accounting data is the reporting of the economic events incurred during the company’s business operations; secondly, accounting must provide useful and comparable information about the company’s economic events that would enable all the users to gauge the company’s performances in order to assist in meeting their individual requirements for their own unique decision-making purposes; and finally, it should also facilitate the understanding of the business decisions made upon such information.

4.3. The concept of value in accounting

Building further on key aspects developed in the preceding sections, the issue of value comes to the fore. This third legitimacy issue delves a little deeper into the meaning of value in order to shed some light on this complex concept. Accounting is confronted with the phenomenon of relative values\(^{28}\) and in the reality of the modern business environment with its many diverse rules and objectives, there is no clear way of knowing whose (or even what) values are reliable or what these values actually present. Even though conventional accounting and financial reporting is based on historical cost

\(^{28}\) Mattesich, R.
accounting, there is a global move to introduce fair value accounting\(^{29} \ 30\). Under the historical cost approach, the actual historical cost incurred for an item is reported, while under the fair value approach the reported amount is approximated by some kind of financial modelling\(^{31} \ 32\), thus removing the direct link between what was paid for an item and the value being attributed to such item. It was mentioned that the effectiveness of different accounting techniques is often judged on its ability to approximate the value of items and transactions. However, the problem is what does value mean and how should it be measured.

In reflecting on the value concept, both quantitative and qualitative value aspects should be considered.

- **Qualitative value perspectives**: As stated earlier, ethical accounting behaviour is more than just a mere adherence to rules and regulations. It becomes the application of ethics in a business context so that the business activities are acceptable in society. The stewardship function is a bit of a contentious issue in current-day accounting with its importance being downplayed in the latest FASB and IASB promulgated accounting objectives. The focus instead seems to be on accounting’s support of the capital providers – which is just one user class in a


multitude of potential user classes. Stewardship however, as a concept that encompasses ethical and moral values, must remain central to accountancy, because it plays an important role in not only the recording and reporting of resource consumption, but also in how created wealth gets distributed. The concept of value in accounting should therefore not only focus on resources, numbers or individual organisations, but should take on a holistic corporate social responsibility approach. Such a responsible stewardship approach belongs to the entire human race, and individual ownership per se should be subservient to the overall stewardship role.

- **Quantitative value perspectives:** Since a key objective of accounting is seen as the financial translation of organisational performances, the quantified accounting information should be disclosed in such a manner that the financial statements are relevant, reliable and comparable. However, how this information is quantified (or valued), will have an impact on this relevancy, reliability and comparability. In a basic sense, value can be seen as some kind of judgment of scarcity and desiredness. These judgments, however, can be described from various perspectives, including the purpose and process of the valuation. Even though there is a move to introduce value-based measurement and reporting techniques, there are also concerns about the subjectivity and non-consistency inherent to such value-based techniques. Notwithstanding the debate on whether

34 Williams, P., Rethinking decision usefulness. (A paper read at the 9th Interdisciplinary Perspectives on Accounting conference held in Innsbruck, Austria), 2009.
historic cost principles or value-based principles are better or not, accounting should remain focussed on the relevancy, reliability and comparability aspects of the reported accounting information. Accounting should remain true to its primary purpose of reporting business facts, not fiction.

4.4. Decision-usefulness as accounting objective

The fourth legitimacy issue to be considered is that of the decision-usefulness objective of financial statements, and then especially such usefulness for investors and credit providers as suggested by key regulators. The capital providers as a user group, are being accorded so much importance by the accounting regulators that a principal function of the financial statements has become the provision of information that is useful primarily to this user category. Even though the concept of decision-usefulness has been a criterion for the determination of accounting policy and defining accounting research for the past four decades or so, there has been some resistance to such a concept as a key accounting and financial reporting objective. As far back as 1964, more than 60% of respondents to the FASB’s discussion memorandum on the objectives of accounting opposed adopting the provision of information for economic decision-making as an accounting objective. An emphasis on this pragmatic aspect for accounting

38 Williams, P.
39 Young, A.A.
requires answering *to whom* the information is to be useful for, and *for what* purpose it is suppose to be useful for. This is where the danger lies because it can become easy to get trapped into defining accounting theory and formulating its postulates and principles in terms of some special interest group.

The question is therefore whether decision-usefulness as a key accounting objective, is as straightforward and unquestionable a way to organise the intellectual and policy-making aspects of accounting as it initially seemed to be. Indistinct allusions to the *usefulness* of accounting information however, are valueless without clarity on the type of utility being sought. This discussion reflects on the relevancy of the decision-usefulness objective from two perspectives:

- Firstly, with specific reference to accounting’s decision-usefulness, the associated concepts of *utility* and *ophelimity* are considered. Utility is seen as being able to be used for a practical purpose\(^4\)\(^2\)\(^3\), with social utility then referring to something contributing to the development of an individual, a population group or even the entire human race. However, when considering the exclusivity of the decision-usefulness objective as it is currently being put forward, it may be argued that the regulators are not really addressing social utility, but rather individual ophelimity. In contrast to utility, ophelimity refers to subjective, individually-based and

\(^2\) Williams, P.
ordinal economic gratification\textsuperscript{44} \textsuperscript{45}. It is doubtful that neither accountants nor the regulators, possess either the linguistic or conceptual capabilities to distinguish between social welfare (utility) and individual ophelimity. It may therefore also be argued that \textit{modern accounting theory} is founded on seemingly different concepts, claiming to promote utility, but instead striving for the ophelimity of a specific user class.

- Secondly, the quantification of accounting data and its predictive abilities are now considered. In respect of the question of the \textit{quantification} it is argued that the accounting information presented in financial statements are not representative of an actual real quantity that exists somewhere in reality, but is rather the result of summarising and estimating techniques aiming to provide a window on a more complex qualitative situation. Accounting should therefore only be seen as a measurement activity in the sense of providing a rough estimate of the reality. In respect of its \textit{predictive abilities}, it is unlikely to possess any real predictive ability because of two reasons. On the one hand, the many different users of the information have different objectives in mind when they use the data and do so against different backgrounds. Therefore, no single set of financial information in a specific format would be able meet the unique individual requirements of users, even within the single group of ‘capital providers’. On the other hand, the market actions that the financial statements and accounting information are supposed to help in predict, operate in such a complex and dynamic environment, with so

\textsuperscript{44} Sen, A.K., The possibility of social choice, \textit{Economic Sciences}, 178-206. (Nobel lecture at Trinity College, Cambridge, CB2 1TQ, Great Britain on December 8, 1998)

many variables and divergent market forces, that it may very well become an impossibility to claim any kind of predictive ability.

The decision-usefulness criteria however, cannot out rightly be rejected, but we rather argue against a vacuous concept of decision-usefulness, devoid of substantive significance. It is suggested that the idea of judgment usefulness in respect of accounting information’s support to the users thereof, should rather be presented.

5. Conclusion

Notwithstanding the searches for a true accounting theory, the debates around which accounting techniques are better, or even who the real users of the accounting information and the associated financial reports are, the overall conclusion is that accounting and the manner in which it is practiced, has a definite impact on human society. Accounting should therefore be considered as a legitimate social science, since it is based on sound scientific concepts and as such it should also be able to provide support to the practical requirements of the business environment. The hypothesis as stated earlier is therefore rejected. This rejection is based on the following arguments.

Firstly, in light of the discussed legitimacy issues, it becomes important to acknowledge the interdependency between philosophy and accounting. Accountants should not be averse to philosophise about accounting – in fact it may be better for accountants to turn to philosophy in attempting to work out the basic theories of accounting, than it would be for philosophers to turn to accounting. Learning about accounting and philosophy in tandem is better than learning about them independently.46

as accounting offers a context in which the quintessence of philosophy may be materialised. The learning of this essence forces us to ignore meaningless words by way of a reality check and stop us from becoming dilettantes taking up the profession for mere 

*amusement.*

Secondly, accounting can only be considered a science if it acknowledges its place in the broader scientific world, which in the first place supposes its own feasibility studies, and secondly at least obeys the rules of logic. Furthermore, being classified as a science certainly also implies that it is directed and led by a certain regulative idea about the reality. When considering the principles upon which the conceptual framework is based, and the logical and reality-based processes followed by the regulators in developing and promulgating it, flawed as some of it might be, it is clear that there is at least some scientific process and reasoning behind it.

Thirdly, accounting is in a difficult position in that the requirements of practice have a major impact on how it is taught, how its theories are formulated and also how and what is researched. However, there are fundamental assumptions in accounting, and its place in the greater socio-economical environment, that have to be considered. Accounting is more than the mere ‘book-keeping’ of business events, or the application of accounting standards. The profession is widely recognised as a key contributor to many aspects of the global *economy*, with many and far-reaching influences on human *society* and the global *environment*, and as such an integrated role player in the so-called *triple bottom line*. Therefore, because of this integrated nature and impact of accounting on society and the environment, one cannot deny accounting its rightful place in the social sciences.

Finally, as in any profession failures also occur in accounting. When such failures do occur, they should not be ignored. Instead they should be analyzed and corrected in an attempt to prevent it from re-occurring. In conclusion therefore, when looking back at the four key issues addressed, the following should be noted.

- Ethics and ethical behaviour, in some form or another, play a crucial role in accountancy, just like in all other scientific disciplines. Just because there are
instances of ethical failures does not take away the legitimacy of accounting’s scientific foundation.

- Even though many accountants and accounting academics get bogged down in the detail of accounting principles and its interpretation, and because of that they often lose perspective, does not mean that the true foundations upon which accounting is built, are any less legitimate.

- It is acknowledged that many users of accounting information often put more trust in the accounting values than what it is entitled to. However, if it is understood that these values merely serve as an indication of a complex state of affairs, and cannot claim to reflect any exact values, basic accounting theory remains legitimate.

- Finally, perhaps the biggest current argument against the legitimacy of accounting theory is its current decision-usefulness objective and its predictive abilities. There are just too many complex variables impacting on the information and the users thereof, that any claim of decision-usefulness (even for an exclusive and precisely defined user group) is nonsensical.

6. **Limitations**

Perhaps a key limitation of many reflective and philosophical studies is the fact that often a definite answer to a problem is not found. However, this is not *per se* the reason why such studies are undertaken. Instead it serves to place current day issues in the context of the *big picture* and to get at least some debate going, which may lead to better and more informed decisions.

A further limitation in undertaking reflective studies in a typically quantified discipline such as accounting is the fact that the objectivity of the disclosed financial numbers, the quantitative techniques and the statistical analysis are lost. In such instances, there is more room for subjectivity and bias to raise its head. Any reader of such studies should in turn take cognisance of such possibilities. Although every effort has been made to remain as objective as possible in this article’s reflections on the issues
at hand, the researcher remains human. As such, personal beliefs, opinions and bias, may be present.

7. Future research

As far as future reflective research opportunities in accounting are concerned, the following may serve as a guide in formulating such research problems:

In respect of ethics in accounting, a philosophical reflection in the context of the conflict of obligation or commitment can be undertaken. The answer to ethical conflict situations where there is a clear right or wrong (or even a clear legal or illegal) answer, should be very easy to answer. However, in many instances there are right versus right issues where legitimate opposing sides or stakeholders are in conflict, both of which may have legitimate and ethical claims.

Furthermore, it was indicated that accounting is a very broad and diverse discipline encompassing areas such as financial accounting, management accounting, financial management as well auditing and internal control. Each of these areas in itself could warrant a reflective study aiming to individuate the deeper foundations of the each focus area’s system of thought.

Finally, there is a close relationship between the philosophical foundations and the historical foundations of accounting. The age when Luca Pacioli documented the double entry booking keeping system, was also the age of many great philosophers, such as Albertus Magnus, Thomas Acquinas, Henry of Friemar, Jean Buridan and Gerald Odonis to name but a few. Historical research into the early days of not only the double entry booking system and other accounting techniques may further enhance modern day accountants’ foundational knowledge and principles of their chosen vocation.