Innovations

Accounting Profession, Public Interest Obligation and Corporate Failure: An Empirical Review

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Abstract

Professional obligation to serve public interest by the accounting profession has witnessed mixed reactions from the general public. The accounting profession has been under criticism for their roles in many corporate failures based on the notion that the accounting profession does not carry-out their function with the interest of the public in mind rather than that of few stakeholders and the self-interest of the accountants. However, public interest has been an abstract notion with no clear definition of who constitute the "public" and what is the criteria to measure their "interest". This study examined the relationship and linkage between the accounting profession, its public interest obligation and evaluated the extent of accounting profession's perceived obligation to the public interest in carrying out their assignments and the effect of a perceived compromised public interest obligation on corporate failures. The study adopted a content analysis review of relevant scholarly articles and pronouncements by regulators and the international and national accounting bodies. Findings revealed that the public, whose interests should be protected, constitutes all stakeholders who benefit from and have interest in the going concern operations of business entities and those who rely on the works of professional accountants. The study recommended that the professional accounting bodies and the regulators should adopt a continuous review of the codes of ethics and should be more proactive rather than been seen as reactive to public criticism in acting and making pronouncements on issues that bothered on accountants' public interest obligation and corporate failure.

Keywords: *1.Public interest, 2.Accounting profession, 3.Corporate failure, 4.Stakeholders, 5.Self-interest*

1. Introduction

The recent financial and economic crisis all over the world has stimulated a number of criticisms ofthe accounting profession. These criticisms were based on the assertion that accountants and the accounting profession generally should play an "intermediation role" between the public (investing and non-investing) and the corporate businesses (Zhang & Andrew, 2014). This intermediation role should be such that while the corporate businesses are pursuing wealth maximisation objective, the accounting profession should protect and report any infraction on the public interest tramped upon in the pursuant of the wealth maximisation objective. The expectations arising from this is that the works of the accountants are expected to reduce, if it not eliminates, the information asymmetry presumed to have been contained in the financial statements. In general terms, it means that such financial statements should take the interest of the public into consideration. Aligning with this assertion, Manabat (2015) opined that one of the hallmarks of accounting profession is its obligation to act in the public interest. This involves the acceptance of the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism (AICPA, 2019).

Therefore, the roles and responsibilities of the accountants and the accounting profession are becoming more pronounced in the face of the public and are becoming increasing as new events and failures unfold in the corporate business world.

Companies that are presumed to be financially healthy are experiencing financial failures while some major business entities are near bankruptcy. In some of the cases of corporate failure and bankruptcy, the causes have been linked to fraudulent or “make-up” financial statements that put much emphasis on the interest of limited stakeholders, particularly that of the managers of the corporations. According to Tudor (2013), these occurrences have eroded public confidence in accounting and indirectly in the auditing and assurance services provided by accountants and in the accounting profession generally. In a similar manner, the International Federation of Accountants (IFAC)in its code of ethics for professional accountants placed emphasis on its mission as contained in the constitution as “to serve the public interest”. This pronouncement of “public interest” has been of emphasis to IFAC with every review of its code of ethics up till the latest pronouncement of April 2018 which became effective in June 2019(IESBA, 2018). The International Ethics Standards Board for Accountants (IESBA), an independent standard setting body under the auspices of International Federation of Accountantshas the responsibility for developing and promoting ethical standards and guidance for professional accountants with oversight provided by the Public Interest Oversight Board (PIOB).

Despite the oversight efforts of the Public Interest Oversight Board (PIOB) on IESBAto ensure that IESBA standards are in public interest and that all member bodies of IFAC comply with its total application as the minimum, the public interest has become a vital code that is under questioning.

However, public interest has been seen as an abstract notion associated with the public benefit, rather than matters in which the public is interested (ICAEW, 2012). ICAEWfurther stated that “the public interest is used by many to justify a wide range of actions and proposals which is often unclear (even to those using them) what they mean by this, and there can be suspicion that the phrase may be used as a smokescreen to garner support for something that is actually in the advocate’s own interest”. The public,in whose interest the accounting profession have responsibility to protect, consists of clients, creditors, governments, employees, investors, the business and financial community, and others who rely on the objectivity and integrity of accountants. Hence, public interest is the collective well-being of the entire community of people and institutions the accounting profession serves (AICPA, 2019).

Accountants, be it in the role of recording of financial transactions and preparation of financial statements, in the role of performing audit and independence assurance on the prepared financial statements or in the capacity of business analysts and financial advisers, have positioned themselves in a strategic position that makes their employers/clients and the public to have great expectations from them to guide their various interests in the accounting profession. These expectations come in form of obligations by the accountants and the accounting profession which may have different implications to stakeholders that have interest in the work of the accountants and the accounting profession.

Professional accounting bodies all over the world are making concerted efforts to ensure that members abide by their codes of conduct that will portray the accountancy profession in good light as having the public interest in mind. The Institute of Chartered Accountants of Nigeria(ICAN) has a professional code of conduct and guidelines for members which, among others, enforces rules of professional conduct as well as ethical and technical standards for members. However, ICAN decided in May 2018 to directly adopt the code of ethics for professional accountants issued by the IESBA (ICAN, 2019). Despite the regulatory enforcement of public interest and all the efforts put up by the accounting profession at the global body level down to the national level and to the individual members of the accounting profession, there is the outcry that the profession’s duty to protect and promote public interest is far from been realised (Murphy &Bennett, 2018). This outcry is basically based on the lack of general consensus as to what public interest is, what public interest duty means and how accountants can achieve it with consideration of the corporate implication to the clients, the economic and social implication to the society and possible legal implication to the accountants and the accounting profession.

Accounting profession's public interest obligation can affect the survival and sustainability of business entities. The continuous survival of businesses has far-reaching effect on the public, be it the investing public, who may have a direct stake in the business, or the non-investing/general public with no direct stake in the business. Corporate failure arising from lack or compromised public interest obligation by the accountants, aside from its direct impact on direct stakeholders, affect the general public by ways of increase in level of unemployment, decreased standard of living, increase in level of crime and indirect effect on other business entities with major patronage for their own survival.

1.1 Objective of the Study

The main objective of this study is to evaluate the extent of accounting profession's perceived obligation to the public interest in carrying out their assignments and the effect of a perceived compromised public interest obligation on corporate failures. The study further analysed the general views about public interest as it relates to the accounting profession and also contributes to the understanding of the complexity involved in the public interest notion.

2. Review of Extant Literature

2.1 Evolution of Accounting and Accounting Profession

There are many stories and historical records about origin and development of accounting, but most writers agreed that it has a long history going back to about 7,000 years as a critical part of business, record-keeping, and life in general. Accounting is one of the oldest profession which has been in existence in one form or the other since the beginning of organised trade and business. Accounting, as a profession, has passed through various developmental stages from the primitive age (the Mesopotamians) of before the 5th century, the middle age or the Medieval period of 5th to 15th century, the pre-industrial revolution of 15th to 18th century the industrial revolution of 18th and 19th century and modern age of 19th century to the present.

History of accounting profession will not be completed without the mention of Luca Pacioli. Accounting was made more meaningful and popular by Luca Pacioli who wrote a mathematics book "Summa de Arithmetica, Geometria, Proportioni et Proportionalità" (summary of arithmetic, geometry, proportions and proportionality)in 1494 that included a chapter on the mathematics of business. This is thought to be the first official book on accounting. Pacioli said in the book "that the successful merchant needs three things: sufficient cash or credit, an accounting system that can tell him how he's doing, and good bookkeeper to operate it."Pacioli's effort popularised the use of the double-entry accounting that had been in place since the late 1300s and remained practically the same until the depression of 1772 when the profession was extended beyond record keeping. The theory and ideas were transformed into a method of determining whether a business is operating efficiently or using an excess of labor and resources. This brought about the idea of Cost Accounting and allowed a professional bookkeeper or accountant to use the numbers to extract efficient data.

In 1789, the United State governmental accounting system was created to account for and manage the treasury of the United States with the double entry theories and practice being adopted. The year 1850 witnessed the British courts rulings where the service of professional accountants is needed to help them with financial information as it related to court cases. The birth of the word "Chartered Accountant" can be traced to 1854 when the petition of a group of accountants in Scotland was acceded to with a royal charter by Queen Victoria. This was followed by the amalgamation of local professional bodies in England to form the Institute of Chartered Accountants in England and Wales, established by royal charter in 1880. In the US, the American Institute of Certified Public Accountants was established in 1887.

Between 1936 and 1938, financial accounting regulation was established in the US and the Generally Accepted Accounting Principles (GAAP) were established by the newly formed Committee on Accounting Procedure (CAP). GAAP was updated in 1953 and new standards were issued with CAP replaced in 1959 by the Accounting Principles Board (APB).The APB suffered from poor management and a weak stance on accounting regulation much like CAP did. In 1973, the APB was replaced by the Financial Accounting Standards Board (FASB). This organisation was created with expanded powers that garnered more respect. The International Accounting Standards Committee (IASC) was founded in June 1973 in London and was replaced by the International Accounting Standards Board (IASB) in 2001 as an independent accounting standard-setting body of International Financial Reporting Standard (IFRS) Foundation.

In Nigeria, some Nigerian with professional training formed an Association called Association of Nigerian Accountants (ANA) which was granted official recognition by the Federal Government in 1965 with the name Institute of Chartered Accountants of Nigeria (ICAN) through the Act of Parliament No. 15 of 1965. A second accounting body, the Association of National Accountants of Nigeria (ANAN) was founded in 1979, incorporated in 1983 and was chartered in 1993 by Decree 76 of 1993.

2.2 Conceptualisation of Public Interest and Corporate Failure

Public Interest

There is a fundamental belief that the existence of any profession is the performance of a service not for itself but for the public. This notion brings to fore the creation of a social obligation to serve the public. Public interest obligation is essential to the accounting profession, however there is a little concession about the expression of the word and what it actually mean.

It is not in doubt that public interest is a very obscure concept that will bring about a very challenging debate. Conceptualising public interest has not been an easy task among professionals and the member of the society arising from the wide and narrow views of the two words that make the phrase. Determining what public interest is and what is in the public interest is a complex process. Bromell (2017) saw the complexity in the public interest phrase by asking the questions: “what and who constitute ‘public’ and what qualifies the ‘public’ to have an ‘interest’ in a subject matter”. Russell (n.d.), in an article on the Institute of Chartered Accountants of England and Wales (ICAEW) web page, opined that “the term public interest is notoriously difficult to define” .He stated that members cannot have a public interest role because they work for clients and as such, like any commercial businesses, are motivated by revenue generation.

ICAEW (2019) perceived public interest as an important abstract notion associated with the public benefit rather than matters in which the public is interested. The emphasis of the phrase here is on benefits to the public regardless of whether the public have or do not have interest in the subject matter. This is an attempt to view public interest from the perception of public benefits, meaning that any activity that will give rise to benefits to the public will be of interest to the public.

This might be in line with IFAC (2012) in the policy position paper 5 where it defines public interest as “the net benefits derived for, and procedural rigor employed on behalf of, all society in relation to any action, decision or policy”. The Institute of Chartered Accountants of Nigeria (ICAN) and other member bodies of IFAC substantially adapted from the guidelines of the IFAC to meet the peculiarities of respective national environment. Hence the concept of public interest is considerably the same across member bodies of IFAC. The summary of public interest definition is the collective well-being of people and institutions the accounting profession serves and to protect the economic interests of third parties (the public) by facilitating an efficient and effective economic decision-making process through the provision of relevant and reliable economic data.

Corporate Failure

Corporate failure can be defined as the inability of a business entity to sustain its existence as a going concern. It is the discontinuation of the basic operations of a business leading to failure to generate enough profit or revenue to meet its obligations. It is a common believe that corporate failure does not happen suddenly, sometimes not even in a year, but with symptoms showing over a period of time. Low profitability, low liquidity and high gearing are among the various financial trends that may show as symptoms of impending corporate failure. Quasi or non-financial factors may include lack of good corporate governance issues such as poorly structured board, dishonest audit committee, insider related transactions, etc.

Although the primary responsibility of accountants in conducting an audit exercise is to express an opinion on the true and fair view of the financial statements prepared by management and presented to them for audit, it is apparent that the accountants have the responsibility to express opinion on the ability of the business entity to continue in operation with nothing visible that can significantly curtail the going concern of the business. Argument can suffice that the expressed opinion is at the date the report is signed by the accountant and as such necessary due care has been taken by the accountant in respect of all interests in the business entity.

Professional accountants, in their capacity, are deemed by the public to have considerable knowledge of the going concern ability of the business in terms of various financial trends and other corporate governance issues.

Adeleke (2016), citing the work of Ajibolade (2008) described professional accountants as the watchdog of the general public when it comes to adding credibility to the financial statements on which they are to express an opinion. Corporate accountants, who prepared the financial statements on behalf of the management of a business entity have been identified in past corporate failures as compromising and colluding with the management to either inflate financial statements understating costs, overstating revenues and general earnings management outside the acceptable accounting concepts and accounting standards (Tseini&Donatos 2006).

2.3 Theoretical Review

Many theories exist in the area of accounting profession and the perceived obligation to the public, this study reviewed some closely related theories.

2.3.1 Public interest theory - Public interest theory, propounded by Pigou (1932), came with the assumption that the economy is flexible with high possibility that it can be operated with inefficiency and manipulated in favour of certain individuals while ignoring the effect on the society as a whole. The theory also holds that it is necessary therefore to regulate the economic market to correct the identified inefficiencies and biased practices in the market. Regulation in this case, according to the theory, is assumed to be costless and should be provided through government intervention. Government regulatory intervention comes through laws and pronouncements from various government agencies. Professional bodies and associations attempt to protect public interest through professional ethics and practice standards.

2.3.2 Public choice theory–The public choice theory was the outcome of the work of Stigler (1972) which was a departure from the public interest theory. Despite the necessity of regulation and the assumptions of Pigou (1932) in the public interest of regulation that regulations do good to the entire society rather than any individual's interest, the public choice theory by Stigler (1972) has a contrasting opinion to the need of regulation. Stigler(1972) was of the opinion that regulations are not socially efficient and they are instrument used by privileged private players to inhibit competitors from entering the market. One of the basic assumptions of public choice theory is that individuals in a political sphere tend to behave rationally and in their own self-interest.

2.3.3 Stakeholders theory – The stake holders theory extends the roles and responsibilities of corporate business and its owner beyond profit maximization to include interests and claims of other groups. The stakeholders theory as authored by Freeman (1984) is a theory that concerns with matters related to morals and ethics in operation of a business. It suggests that a business, of which the accountancy profession is one, must seek to maximise value for its stakeholders. The traditional definition of stakeholder is a subset of the public comprising of "any group or individual who can affect or is affected by the achievement of the company's business objectives" (Freeman, 1984). The stakeholder concept is a redefinition of organisation culture towards a larger populace in which a business, trade or profession is been carried out.

Just as the word "public" is an abstract notion, so is the word "stakeholder". The traditional definition of stakeholder as stated by Freeman did not gives clarity as to what constitutes a stake in a business and how such stake can be acquired. This lack of clarity has been contested in literature and this definition has changed over the years. Freeman (2004), in responding to the contentious issue around stake of a holder in a business, redefined stakeholders as "those groups who are vital to the survival and success ofthe corporation".

2.3.4 Theoretical Framework

The study is anchored on public interest theory which assumed that economy, if left unregulated, can be manipulated in favour certain groups to the detriment and disadvantage of the general public. The practice of accounting profession has been subject of regulations by the local and global accounting bodies and also various enactments of the relevant governments regulating the conduct of business in the public domain.

2.4 Empirical Review

Tudor (2013) studied the dilemma of the accounting profession in balancing the public and private interest in the course of their assignment. The study clarifies the conflict between public interest and private interest and also evaluates the efforts of IFAC in ensuring that professional accountants all over the world serve the public interest in all their assignments and restore confidence on the accounting profession. The study concluded that the accounting profession can be further strengthen in the area of public interest and public confidence if the accounting profession continually review the auditing standards and the code of ethics particularly those areas relating to professional accountants independent and conflict of interest.

Davenport and Dellaportas (2009) conducted an exploratory review of the knowledge and interpretation of public interest among professional accountants in Australia collecting data through the administration of questionnaire. The study found out that the respondents, who are all professional accountants, understand the meaning of the public interest and what public interest of a professional accountant means, but the concept in way thatis not consistent with its formal meaning. The finding of Davenport and Dellaportas (2009) in respect of clear understanding of the concept of public interest is at variance with the opinion of some professional accountancy bodies and researchers(Baker, 2005; CIMA, 2010, AIA 2011) that public interest is a difficult phenomenon to understand when it relates to professional rendering service to the public. As a caution and in alignment with the opinion of most researchers, Davenport and Dellaportas (2009) further stated that the findings of the study should be interpreted with caution as it may not be the views of a larger community of accountants citing the reasons of respondents from only one of the three major accounting bodies in Australia and also the relatively low response rate of below five percent which inhibit the generalisation of the finding.

Fulop (2013) adopted the qualitative approach to examine the issue of serving the public interest as the main characteristic of accounting profession. The paper described public interest as very important to the accounting profession because it is a label of accounting profession in its acceptance of the responsibility to act in the public interest as laid down in the code of ethics of the profession by IFAC. Despite the divergent opinions about public interest, as observed by Fulop (2013), the study affirmed the vital role of the accounting profession in the society at large. It concluded that the public relies on the objectivity and integrity of the accountants and this reliance created a trust that should be upheld by the accountants.

In the words of Baker (2005) who carried-out a conceptual study evaluating the role of accountants in line with the mission statements of some accounting bodies and practices that incorporate the attitude and act of public interest in their engagements. The study covered the Financial Accounting Standards Board (FASB), American Institute of Certified Public Accountants (AICPA)and PricewaterhouseCoopers (PWC).The result of the study revealed that there is a disconnection between the activities of the accounting profession and the public interest they assumed to serve and protect. This revelation post a question on the sincerity of the accounting profession on the absolute compliance to the IFAC code of ethics for professional accountants of serving the public interest.

Ardelean (2013) discussed public interest in relation to the accountancy profession. In looking at some perspectives, the methodology adopted by the paper was a qualitative approach and analytical in nature by examining the IFAC framework, comments and recommendations of accounting professional bodies and audit firms. The author found out that the complexity of the public interest concept makes it difficult to define what public interest is. However it was agreed that the ethical and public interest frameworks by various accounting regulatory bodies reinforced the public confidence in the works of accountants and the accounting profession. The paper concluded that although the accountants and the accounting profession have a responsibility to protect public interest at the same time trying to ensure the interest of the profession and the clients, it is difficult, but crucial, to strike a concession between the interests.

Paisey and Paisey (2020) evaluated the level of protection of the public interest by looking at the contribution of the continuing professional development (CPD) policies of twelve accountancy bodies, including two globally-reached bodies (ACCA and CIMA). The study analysed the claim and notion of the CPD policies of serving the public interest of the accountancy bodies and found out that there is contradiction

3. Methodology

The study adopted a content analysis review of relevant scholarly articles, pronouncements by international and national accounting bodies and opinions of notable international public figures in the accounting profession on the subject of public interest, public trust and corporate failures.

4. Discussion of Findings

Professional obligation to serve public interest by the accounting profession has witnessed mixed reactions from the general public and the accounting profession itself. Despite the pronouncements of the accounting regulatory bodies on the need for accountants to put public interest in the forefront in the conduct of their works, the personal and business relationships with clients and clients' managements have over time generate conflicts of interest. These personal and business relationships had provided hurdles to objective and impartial decision making which hitherto has threatened the independent of the accountants. The word "public interest" has become more of interest to the accounting profession because of the nature of their works and the reliance placed on them by the public. The continuous experience of corporate failures all over the world has made more popular the expression "public interest in the accounting profession". Public interest in the accounting profession is an expression that comprise the well-being of the customers, the employees, investors, suppliers, the service organisation and the society at-large. This means that public interest, as an expression, is the collective well-being of the society and the organisation the professional accountants primarily serve. It implies that the obligation of a professional accountant to serve the public interest is not limited to any specific group or individuals but to all stakeholders., directly or indirectly, in the business

The mention of stakeholder is another far-reaching expression that should guide the accounting profession in their bid to ensure fulfilment of their obligation to the public. The implication is that the accounting profession has duty of care to many parties despite not having a direct contractual relationship with them.

Major corporate failures in which the accountants have been found culpable in their due diligence responsibilities and their principal objective of providing reasonable assurance about whether the financial statements as a whole were free from material misstatement have raised question of whether the accountants have the public interest in mind when reporting about the going concern of the entities.

The going concern assumption is perceived from the accountants' view point to be as at the reporting date which the statement of financial position carried. It should be assessed with objectivity and observation of any noticeable things that can significantly threat the going concern assumption within the next accounting period. Although this may be difficult, it is the expectation that where such is reasonably ascertained, it should reflect in the accountants' opinions.

The fact that the entire public place reliance on the accountant's opinion on the financial statement is enough to put the reporting accountants on notice on the interest of the public in their works.

The shocking collapse of Enron and the subsequent demise of one of the professional accounting giants - Arthur Andersen took the entire business world and the accounting profession by surprise. The bankruptcy of WorldCom, the scandals involving Parmal at in Italy, HIH Insurance in Australia and Equitable Life Assurance in the UK, among others, gave rise to question whether the accounting profession has not just the self-interest or the interest of very few in mind when reporting and giving professional opinion on the financial statements of their clients as against the interest of the public, including investing and non-investing public, at large.

Most recent are the accusation of complicity of PwC and EY in the 2019 collapse of Thomas Cook and the sanction of UHY Hacker Young over the 2020 collapse of fashion retailer – Laura Ashley by the Financial Reporting Council (FRC) UK for failure to challenge or investigate management's use of going concern assumption despite this being apparent as a significant risk.

The recent collapse of Thomas Cook impacted an estimated 600,000 travelers all over the world on the day of collapse(Martinez & Buyan, 2019). This is aside from millions of other customers, thousands of employees, suppliers and partners who has indirect interest in the company. Laura Ashley's collapse led to closure of their 155 retails stores in UK with employees of over 2,700 affected (Nazir, 2022). The FRC disclosed that the audit breaches by the audit firm which include non-modification of the 2018 and 2019 financial year reports did not directly lead to Laura Ashely's collapse. However, it stated that the audit failed in principle objective of providing reasonable assurance to the public on the going concern of the business.

5. Conclusion and Recommendations

Although the philosophies behind the role of accountants lay much emphasises on obligations to the public in the cause of doing their works, there is no clear and acceptable definition of the public interest, who should constitute the public, the interest they have and how such interest can be protected individually without conflicting each other. Understanding the public interest in accounting has been a dilemma because the definition of the public interest has remained elusive.

It is obvious that the public interest obligation of the accountants and the accounting profession has a significant impact on the corporate failures which ultimately impacted the employees, customers, suppliers and the public with one interest or the other. The recent cases of Thomas Cook and Laura Ashley provide the evidence of relationship between public interest obligation of the accounting profession, corporate collapse and the ultimate effect on the public.

The accounting profession has been criticised for too much emphasis on self-interest rather than the interest of the key stakeholders. Self-interest is paramount in any profession or endeavour and not just in the accounting profession, it should not be associated with negativity alone. Self-interest can be associated with public interest and so much it is not pursued at the detriment of other stakeholders, it will enhance public interest. Hence, it must be noted that the pursuit of self-interest is complimentary to public interest and not competing with public interest.

To enhance the public confidence in the accounting profession's public interest obligation, the professional accounting bodies and the regulators should adopt a continuous review of the codes of ethics to ensure the expected professional behaviour that will provide mutual benefits to the accounting profession and all interested parties. Despite the not-too-clear and no generally acceptable definition of public interest, obligation of members in serving public interest should be more pronounced in relevant codes of ethics and this will likely enhance public confidence.

Although some sections of the public may see the emphasis on public interest in the codes of ethics as a mere window dressing and an attempt to sell whatever behaviours of the accounting profession to the public as having incorporated public interest, the accounting professional bodies and the regulators should continue to make infringements or infractions by members, the consequences and penalties on concerned members known to the public.

The accounting professional bodies and the regulators should be more proactive rather than been seen as reactive to public criticism in acting and making pronouncements on issues that bothered on accountants' public interest obligation and any corporate failure that may have arisen within their jurisdictions.

The degree of independent of accounting profession is another factor that has been linked with public interest obligation. The degree of independent may be compromised by the nature of multiple services render by accounting firms to their clients. Accounting firms should do much in separating their audit businesses from other businesses. The accounting firms have come under pressure over the years to embark on major restructuring to handle potential conflicts of interest that affects public interest obligation and avoid future accounting scandals and corporate failures. This will be in line with the radical break-up plan by one of the big four firms, Ernst & Young to separate its audit and advisory businesses (Kollewe, 2022; Maurer & Eaglesham 2022).

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