ASSOCIATION FOR INTEGRITY IN ACCOUNTING ENTERS THE DISCUSSION OF ACCOUNTING REFORMS

By ***Paul F. Williams***

The classic, sympathetic view of a profession is that of a calling: something one does that is inherently worth doing because it is an essential social function. Many of us who have been called to accounting feel that something has gone very wrong with our profession of late. Accounting is no longer described as a profession but as an industry, dominated by global oligopolies concerned primarily with growing their revenues by any means (e.g., "assuring" rather than auditing, structuring complex transactions of questionable economic merit, and assisting well-paid CEOs in evading income taxes). One of these large firms obstructed justice and imploded. The remaining four are either under investigation by the SEC or IRS or are being sued for many millions of dollars by the parties they have allegedly damaged.

The behavior of these most public of public accountants has taken something important from all of us: the assurance that practicing or teaching others to practice accounting is an honorable way to spend one's life. Every profession is sullied by the behavior of the occasional bad apple, but mechanisms usually exist that allow for the removal of the offender from the barrel, which is still solid. Recent events pose accountants with the question of whether what has been taken by the bad apples is the very integrity of the barrel itself, the structure within which we understand and practice accounting. A small group of accounting practitioners and academics have started an organization called Association for Integrity in Accounting (AIA), under the auspices of Citizenworks (www.citizenworks.org), an organization founded by Ralph Nader, in order to attempt to reclaim what we have had taken from us:

> The basic mission of AIA is to provide an independent forum to present and advance positions on a wide range of critical accounting and auditing issues, standards and regulations affecting the accountability and integrity of the profession, and the public interest in maintaining trust and confidence in accounting.

The AIA has identified four goals as its initial focus. The first is to watch the watchdogs. The number of groups that had to fail in doing their jobs conscientiously in order for the Enron scandal to occur is startling: It includes management, the board of directors, the audit committee, auditors, analysts, SEC, state corporate regulators, banks, and FASB. The lack of useful research on the system of financial standards-setting and reporting is remarkable. For example, FASB, without any real understanding of the consequences, has radically altered the model of accounting measurement by defining liabilities in an extra-legal sense and by creating complex formulae for present value measurements (e.g., derivatives and postretirement benefits) for which there exists no objective way to provide assurance. Financial statements are increasingly not auditable. The AIA will be a forum for gathering information relevant to assessing how we can make the standards-setting process and regulatory structures more effective and trustworthy.

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The second goal is to contribute to restoring professional independence. The illustration I use with my students to emphasize the essence of "professional accounting" is the perennial parade of tuxedoed CPAs before the audience at the Academy Awards. I tell my students those accountants are there not because counting the ballots is such a technically complex task; anyone can do that. They are there because people believe they can be *trusted* to count the ballots. The conflicts of interest that exist in the current environment of financial reporting and auditing provide an incentive structure biased against trusting anyone. The AIA plans to join the discussion on how we might alter the incentive structures in the financial reporting and auditing environment to increase the amount of trust inherent in that system. For example, the Government Accounting Office (GAO) has remained relatively scandal-free and GAO reports are highly regarded as reliable and objective. One reason this may be the case is that the GAO incentive structure rewards independence; the consequences of issuing biased reports would be catastrophic for the agency. The same incentives should exist for auditors. The funding, selection, and rotation of auditors are issues that the AIA plans to address.

The third goal is to work toward ensuring corporate accountability and disclosure. When the U.S. Constitution was drafted, large corporations were not the dominant institutions in our society that they now are. The few corporations that existed were chartered by states for limited periods of time to perform limited activities; no reference to corporations appears in the Constitution. Today, corporations have been extended the same rights as flesh-and-blood individuals yet are exempt from many of the responsibilities of citizenship. For example, they do not serve on juries or in the military, and they never face the prospect of being found guilty of a capital crime. Unlike our ancestors, most of us are totally dependent on corporations for our basic necessities. The behavior of these enormously powerful institutions has innumerable consequences for everyone, not just their shareholders. The AIA will work toward increasing the transparency of traditional financial disclosures and will also work to resurrect public interest in the concept of expanded accountability for public companies. All "stakeholders" need to be well-informed about the consequences of corporate conduct.

The fourth goal is to redeem accounting education. Perhaps the most culpable institution in the current environment of corporate corruption is the accounting academy. What were the people in the recent parade of perpetrators taught about professional conduct? What do they understand accounting to be? Since the late 1960s and early 1970s, the teaching and research of accounting have undergone a dramatic transformation. This transformation involved substituting the fundamental, traditional metaphor for accounting of accountability (stewardship) with that of "information." Within the leading institutions of higher learning, accounting has been transformed from an autonomous discipline such as law into a laboratory practice for neoclassical economics. The consequences of this transformation are significant.

First, accounting researchers now seem more interested in proving that an imaginary world is real than in the genuine understanding of accounting phenomena. Second, accounting education now teaches very little about accounting. Accounting textbooks increasingly resemble finance texts. Accounting is financial statement analysis; debits and credits are relegated to an appendix or to a supplemental textbook for a bridge course. If "information" is the purpose of accounting, why don't we rely on statistical sampling, which would be far more efficient than recording every transaction? Current textbooks do not do a very good job of explaining to students why we have such an inefficient information-gathering system for predicting the timing, amount, and uncertainty of cash flows.

Third, and perhaps most important, the neoclassical model of human nature provides a language that contains no terms with which to make ethical judgments. Rational economic people are rational so long as the means they select are effective for achieving their purposes, whatever those purposes might be. To use an extreme example, with only the rational economic man model of human nature, it is not possible to utter a moral condemnation of murderers. Given their "utilities," what they do is perfectly rational (a Nobel Prize in economics was awarded to Gary Becker for the demonstration of this truth), and within the neoclassical model of man the only sin one can commit is means-ends irrationality. The rational man can be dumb, but not immoral. So for the last 30 years accounting has largely been taught as merely a technology for facilitating means-ends rationality for economically rational persons. Historically, however, accounting has been, if nothing else, a moral code for the conduct of business, a notion that has largely disappeared from the accounting classroom.

The AIA intends to begin a serious public discussion about what is missing from the accounting curriculum and its scholarly agenda. This will require input from both practitioners and academics. Training for business consulting seems not to have produced a competent professional in the classical sense of that term.

I conclude with an invitation to all of you who read this and believe there is some element of credibility to any of AIA's goals. Please join the organization and offer your opinions, insights, resources, and energies. You can acquire more information about AIA and sign up online at Citizenworks.org. ❑

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Letters to the Editor

CAN INTERNAL CONTROL STOP MANAGEMENT FRAUD?

Professor Manuel A. Tipgos provides an interesting discussion "Why Management Fraud is Unstoppable," December 2002, but I would ask him to reconsider several points.

First, the Foreign Corrupt Practices Act of 1977 included an amendment to the Securities Exchange Act of 1934 which clearly stated that:

(2) Every issuer which as a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15 (d) of this title— (A) make and keep books, records and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—(i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (II) to maintain accountability for assets: (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

Doesn't this amendment impose responsibility on top management for internal control?

Second, doesn't the Treadway Commission Report, in *Exhibit 1-2*, imply that the *entire* organization, including the board of directors and the chief executive officer, is within the internal control environment? It seems clear to me that internal control is not below the top level of executives. It would help to have the author's support for the statement that "[an] important shortcoming of the Treadway Commission was its failure to authoritatively state that management is not above the controls recommended." My reading of the report does not support such a shortcoming.

Finally, AU section 110.03 states that "Management is responsible ... for establishing and maintaining internal control that will, among other things record, process, summarize, and report transactions..." The annual reports of many publicly owned companies include a statement, signed by key executives,