Accounting, Organizations and Society 36 (2011) 109–124

Contents lists available at ScienceDirect

Accounting, Organizations and Society

journal homepage: www.elsevier.com/locate/aos

To tell the truth: A discussion of issues concerning truth and ethics in accounting

Mohamed E. Bayou [a,1], Alan Reinstein [b,2], Paul F. Williams [c,*]

[a] School of Management, University of Michigan-Dearborn, Dearborn, MI 48126-2638, United States
[b] School of Business, Wayne State University, Detroit, MI 48202, United States
[c] College of Management, North Carolina State University, Raleigh, Box 8113, NC 27695-8113, United States

A B S T R A C T

Such major scandals as the savings and loan failures in the late 1980s and 1990s, the Enron, Global Crossing, WorldCom and Tyco corporate scandals, Arthur Andersen's demise, and the current crisis of the financial system have all been linked directly or indirectly to false, misleading, or untruthful accounting. Thus, in a pragmatic sense the question of the veracity of accounting or what it could mean for accounting to be true seems to exist. The assertion of a false or misleading financial report implies some belief that there could exist a true or not-misleading report. Accounting-standard setters have finessed this issue by agreeing that "decision usefulness," not truth, is financial reporting's ultimate objective. Over time they have gravitated to a coherence notion of truth to provide rationales for accounting policy. The result has been a serious conflict between the content of financial accounting and the auditing of that content. In this paper we describe this conflict and its consequences and, relying on John McCumber's work, provide an argument about how accounting scholars and practitioners might begin to think more cogently about what a truthful type of corporate reporting might be. We suggest that accounting-standard setters have too narrowly construed what accounting's role in democratic society is and how the contradictions of current standard-setting jeopardize the essential professional franchise of accountants, the audit function.

Introduction

The accounting profession continues to struggle with the problem of the veracity of accounting reports, in light of the different needs of various financial statement readers for truthful reports. The savings and loan failures in the late 1980s and 1990s, the Enron, Global Crossing and Tyco corporate scandals, Andersen's demise, and the sub-prime mortgage crisis all relate to *deception*. All such scandals involved to varying degrees the telling of accounting untruths, which raises the question: what possible meaning(s) can be given to accounting being true? West (2003, p. 172) trenchantly enunciates why accountants should be concerned with the truth: "It is on grounds of its claimed expertise that the accounting profession has been granted an exclusive responsibility for independently pronouncing on the truth and fairness of financial reports. Responsibility to define "true and fair" runs parallel to this privilege."[3] All

* Corresponding author. Tel.: +1 919 515 4436.
E-mail addresses: mbayou@umd.umich.edu (M.E. Bayou), a.reinstein@wayne.edu (A. Reinstein), paul_williams@ncsu.edu (P.F. Williams).
[1] Tel.: +1 313 593 9962.
[2] Tel.: +1 313 577 4530/248 368 8841.

0361-3682/$ - see front matter
doi:10.1016/j.aos.2011.02.001

[3] Frankfurt (2006, p. 34) notes the importance of truth for all of us: "Civilizations have *never* [all emphasis in original] gotten along healthily, and *cannot* get along healthily, without large quantities of *reliable factual information*. They also cannot flourish if they are beset with troublesome infections of *mistaken* beliefs." MacIntosh (2006) provides an entertaining and insightful discussion of accounting "truthiness" via Frankfurt's earlier treatise *On Bullshit* (Frankfurt, 2005).

50 US states give CPAs a monopoly to fulfill the public's expectations by assuring that financial reports are not misleading or fraudulent. But to claim something is misleading presumes that some idea exists about what is a truthful versus untruthful financial report. Accounting-standard setters have finessed this issue by asserting in SFAC #1 (FASB, 1978) that only decision usefulness, not truth, is financial reporting's ultimate objective.[4] The question of true accounting creates a problem that the profession couches largely as a technical, economic measurement matter, wholly ignoring the problem's profoundly ethical ramifications. Using McCumber's (2005) work on the question of truth, we provide some perspective on the inter-relatedness of truth and ethics in accounting by arguing that: (1) truth represents a genuine problem for the profession and for financial statement preparers and users; (2) the apparent inadequacy of the current financial reporting system arises partially from misconstruing the nature of the term truth; (3) accounting truth inescapably has a significant ethical dimension; and (4) understanding all this implies a different perspective to decide public policy on corporate reporting issues especially including what are the reporting issues.

The section following this introduction examines everyday language usage to illustrate the presence of peoples' expectation that accounting reports convey something truthful. The third section discusses the dilemma of truth in accounting created by standard-setters' reliance on the decision usefulness criterion to justify accounting standards. The fourth section describes the essentially ideological origins of decision usefulness. The fifth section discusses truth to provide a more pragmatic way to consider truth in the context of accounting reports. It describes an alternative formulation of the concept of truth and discusses the essentially ethical nature of accounting as a practice whose function is to relate particularly important narratives (accounts) about social relationships. We also present a summary and conclusions.

The expectations for a true accounting

Accountants have long used normative terms to describe essential features of accounting practice. Several western countries use the term truth in their auditors' reports. The United Kingdom (UK) accounting profession has used the expression "true and fair view" since the 1947 issuance of the UK Companies Act.[5] From 1879 to 1947, the UK Companies Act of 1879 (Myddelton, 1995) used "true and correct". The Australian auditing profession has used "true and fair" since issuance of the Financial Corporation Act of 1974 (Chastney, 1975). Since 1998, under the International Accounting Standards Committee's (IASC) auspices, the European Union (EU) requires fair presentation and disclosure of compliance with International Accounting Standards and a limited "true and fair view" override if compliance is misleading (Official Journal of the EU, 1998, 1978). However, after a detailed comparison of accounting practice in Spain, Sweden and Australia, Blake, Amat, and Gowthorpe (1998) report many problems in implementing this term, and ascertaining whether countries should use the term "fairly present" (the US standard) or "true and correct." Feige (1997) reached a similar conclusion in studying the German accounting practice.

The US accounting profession uses several mechanisms to promote truthfulness, such as harsh penalties for violating the AICPA code of ethics, certification, a conservative culture of professionalism, professional skepticism, Securities and Exchange Commission's (SEC) rules, and such laws and regulations as Sarbanes–Oxley (SOX). But such attempts apparently have not eliminated the belief that there is still considerable deceptiveness in financial reporting.

The adjectives used to describe recent accounting scandals indicate the pervasiveness of belief that some kind of veracity inheres in accounting reports.[6] The press has lately described financial statements as false, misleading and even fraudulent. For example, Akerloff and Shiller (2009, p. 29), two prominent economists, one of whom is a Nobel laureate, opine on recent financial corruption, "There are a large number of ways to take this money out, including salaries, bonuses, sweetheart deals, nepotism, high dividends, and options (which themselves will have kited values because the *accounting makes it appear that the firm is doing better than its true performance* (emphasis added))." Shaub and Fischer (2008, p. 319) argued for three values central to accounting ethics education, one of which is to tell the truth, i.e., "The second common value that should be readily embraced by the accounting profession is a commitment to tell the *truth* (emphasis added)." The US Government Accounting Standards Board (GASB) *Concepts Statement No. 1* states that: "Public accountability is based on the belief that the taxpayer has a 'right to know,' a right to receive *openly declared facts* (emphasis added) that may lead to public debate by the citizens and their elected representatives" (GASB, 1987, p. 1).

Firms often must restate reports, implying that the prior ones were less correct (untrue). A major, recent accounting scandal involved finding the head of Kmart guilty of misleading investors. A news report on the case quoted the jury verdict: "The jury, however, found that

[4] The joint concepts project between FASB and IASB asserts that decision usefulness is the only criterion necessary for deciding accounting standards.

[5] Sunder (2009) recently argued for "True and Fair as the Moral Compass of Financial Reporting." His argument is predicated on his assertion (Sunder, 2005) that accounting is better as a matter of social norms rather than an expanding list of more-and-more complex rules. To perform their regulatory purpose, social norms invariably carry ethical force even if based on merely technical considerations.

[6] Ijiri's (1975) classic analysis of the axioms of historical cost accounting emphasized the essential factual quality required of representations that affect accountability relationships. He coined the term "hardness" to emphasize the central importance of accounting numbers being fact-like with respect to the actions taken by accountable parties. Income theorists Edwards and Bell (1961), Sterling (1970), and Chambers (1966) argued for the inherent objectivity of business income measurement, emphasizing the centrality of factuality with respect to value rather than the factuality of actions.