Illegitimate Issues of Legitimate Accounting : World without end

Asok Mukhopadhyay

The history of accounting is replete with stories of fraud. Through the ages, these so-called scandals have caught public-investors unaware, leaving them penniless, begging for explanations. And when answers become elusive, it leaves way for slander, and distrust. In this case, the figure of 'accountant' has borne much of the blame. They have been held responsible for breaking public trust, indulging in unethical practices behind their backs. However, this is not without historical precedent.

On 10th November 1494, it is believed, Franciscan Friar Luca Pacioli published his ground-breaking compendium on mathematics, Summa; that contained a section on book-keeping, which has led the way for accounting studies, as we know it today. Accountants worldwide commemorate this event by celebrating it as International Accounting Day. The day is also observed as Commerce Education Day. While the good monk's treatise, the first-ever printed publication on the subject, canonized the very basis for practicing accounting, it also disclosed crucial information on the practices and customs of the merchants of medieval Venice. These merchants, kept two sets of books, one for the buyer, the other for the seller. A sly trick, employed solely for personal gain.

This distrust goes back to biblical times as well. The Bible talks about Jesus expelling merchants and money changers (accountants) from the Temple accusing them of turning the temple into 'a den of thieves' through their commercial activities. Given this sordid reputation, it is counterintuitive, that a day is celebrated as International Accounting Day.

When the Medici Bank, the largest medieval banking conglomerate, with offices in Rome, Venice, Bruges, London, Pisa, Avignon, Milan, Lyon, Geneva and Basel, banker of the papacy and patron to some of the renowned artists of the Renaissance became insolvent in 1494, incidentally the same year as the publication of Pacioli's Summa, the reasons were the same: fraud, irregular accounting practices, insufficient reserves and a complete lack of corporate governance. Machiavelli even accused the Medici Bank managers of acting more like princes, than sensible businessmen.

If we follow the greatest, the largest accounting scams of the past centuries, a pattern starts emerging. A pattern that holds true for possibly all human pursuits. That a large number of innocents, innocuous bystanders getting trampled beneath the greed of a few without any guiding regulations to keep such malicious intent in check.

Yet the role of accountants is critical to society. The work they do is highly sensitive and surprisingly diverse. They serve as financial reporters to the stakeholders. The expertise they provide is crucial in making critical economic decisions. How do we balance this duality of perception and make way for a kind of accounting that expunges this greedy, deceitful past?

The answer may not be that simple. But as always, it is helpful to learn from past misdeeds for example the cases of speculative mania. It goes beyond betraying the trust of a few investors, into full-fledged nation-wide panic and economic ruin. This is done by creating asset bubbles. The trade in an asset takes place at an increased, often unrealistic price that far exceeds that asset's intrinsic value. The Tulip Mania in Holland, between 1634 and 1637, probably stands as history's most shining example of such a case. The country faced an economic crash, the proportions of which were hitherto unknown to the world. The demand for a bulb of tulip escalated to such extremes that people started pledging their homes as collateral security. And when the prices crashed, it wasn't a pretty sight. Charles Mackay, in 'Extraordinary Popular Delusions and the Madness of Crowds', published in 1841, claims that Dutch commerce sustained a severe shock, and scores of people were left penniless. This crisis, delved into history, has even inspired a film by Justin Chadwick, 'Tulip Fever', which was released a couple of years back.

This was followed, hardly fifty years later by the collapse of Mississippi Company of France which in turn coincided with the popping of Great Britain's South Sea Bubble. The scandals plunged France and the rest of Europe in a significant economic depression, laying the groundwork for the French Revolution, later in the century.

To regulate trade and other commercial activity, public accounting bodies started forming around the world. It started with Italy in 1865, followed by the U.K. in 1880 and the USA in 1887. India joined in, in 1949. But, the scandals never stopped. In just the 2000s, scores of such cases have been reported, resulting in fraud charges, bankruptcy and closure of heavyweight companies and accounting firms.

'Fiddling of profits, cooking of books of accounts, changing of figures in order to protect the guilty are some of the biggest cons since the Trojan horse. In fact, this deception is all in perfectly good taste. It is totally legitimate' says Ian Griffiths, in 1986, calling it 'Creative Accounting'. Though historically used for institutional greed and personal gain, these practices aren't inherently bad in themselves. And if used wisely, this can lead to parity in distribution of dividend, even on bad days, because a chunk of surplus can be kept hidden, in reserve. But more often than not, it is taken too far, while trying to paint a pretty picture in times of imminent crisis, Accountants then hide organizational weaknesses through clever misuse of funds, financial misstatements, fictitious transactions, business loan without putting any collateral, inflated sales, inflated revenues, understated earnings, misleading accounting practice, fraudulent spending, overstated assets and understated liabilities, overstated cash flow, falsified accounting documents. It is difficult to find objectivity in accounting techniques that disrobes the limitation of the subject itself. And the flexibility allows accountants to creatively maneuver their reporting.

Only and complete shift of the accounting paradigm can then, truly and meticulously usurp such practices from the world. A world where investors don't live in constant fear of losses, where there's complete objectivity in our techniques, leaving no room for 'creativity', for lack of a better term. But till then, it is on us.

Instilling a clear and strong sense of ethics in young accountants today, can be small step forward. Because accountants need to understand the responsibility they carry, and the ethical and moral implications of what they do. The students of accounting need to be exposed to Bentham's Utilitarianism or to the field of study that involves establishing concepts of right and wrong behavior.

Countries having specialized public bodies of Financial Accountants, Cost Accountants and Management Accountants created essentially for special purposes, may form an integrated team. In the USA, the Certified Public Accountants (AICPA) and the Chartered Institute of Management Accountants (CIMA) came together to form the Association of International Certified Professional Accountants for appraising accounting practices from different lenses. India might also find it beneficial to merge its public accounting bodies, to make way for holistic and unbiased scrutiny.