Andrea Mennicken and Martin Lodge consider the likely disappointment of contemporary reform initiatives

Barely a day goes by where calls for reform in accounting regulation do not feature in the headlines. Whether it is calls for tighter controls over conflicts of interests, ethical behaviour, or changes to market structures to enhance competitiveness, taken together all these debates seem to signal a determination to tackle deep-rooted problems in the accounting profession. Yet, however valuable these calls are, the potential solutions to the diagnosed problems are likely to disappoint. Since regulating accounting is about regulating a distinct ‘wicked issue’, simple solutions won’t do.

Current key criticisms relate to questions of market structure, auditor independence and auditor judgement. Questions about the power of the ‘big four’ accounting firms (Deloitte, E&Y, KPMG, PwC) highlight the considerable market concentration of large accounting firms, whose influence is further advanced by the close connection of accounting with associated consulting services. Another concern is the competence of individual professionals to properly ‘audit’ firms and exercise a sufficient degree of scepticism in their assessments, for example in their judgement of large uncertain accounting estimates, including fair value estimates and impairment write-downs. Furthermore, there are quests for a reform of the Financial Reporting Council (FRC) leadership (drawing on US SOX legislation). As we are awaiting the findings from the latest review of accounting regulation, the inevitable toing and froing over actual reforms, we should bear in mind the long lineage of criticism facing accounting regulation. Accounting regulation is a wicked issue – it has multiple dimensions and no stable solution, and how problems are being defined inevitably leads to particular, partial solutions, which in turn, generate their own vulnerabilities. While therefore increased spotlight on the world of accounting regulation can only be welcome, it is fairly unlikely that any subsequent reforms will mean an end to questionable practices, concerns about market structures or accusations of missing ‘red flags’ in future insolvencies.

None of the above outlined initiatives (auditor/audit firm rotation, prohibition of non-audit services alongside audits, introduction of joint audits), is likely to lead to significant reforms as they do not go to the core of the ‘wicked issue’ character of accounting regulation. At one level, there is a problem of the target of regulation. On the one hand, accounting regulation is about professional standards aimed at the governing of individual professional conduct (individual independence, competence, objectivity, etc.). On the other hand, individual professionals operate in an organizational context of an audit firm context, which brings with it a number of different issues. Some of these issues are related to audit firm governance, internal incentive and compensation structures, client management and retention demands, and so forth.

At first sight, calls for ‘more scepticism’ in auditor judgements sound plausible in view of accusations that recent bankruptcies have found accountants to be asleep at the wheel. However, what exactly ‘scepticism’ implies is far from clear. Most of all, this defines the problem as one of independent judgement at the level of the individual. Yet, most decisions are the result of a set of interconnected decisions which are often reached at group level. This ‘many hands problem’ in regulating accounting cannot be addressed by solely relying on measures aimed at increasing individual scepticism. Auditor judgements, to a great extent, are ‘distributed’ judgements that rely on the input of a number of individuals and effective coordination and drawing together of audit work. Furthermore, auditor judgement is increasingly aided by technology, including big data and algorithmic, machine learning technologies, which in themselves require a rethinking of traditional audit regulation and oversight arrangements.

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2 See also Auditor scepticism: raising the bar issued by FRC’s Auditing Practices Board in 2010, London: APB.

REFERENCES

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