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THE END OF INNOCENCE?

> Latest on the carpet, the austere, unfathomable accountant is being shown up as a master of misrepresentation, a cordon bleu at cooking the books. With his fall, the idea of "the professional man" is near to being swallowed up in contempt. (Barzun 1978: 61)

The headlines and images will not go away — images of corporations failing or being forced to restate their financial results; of well-dressed executives being led away in handcuffs; of pensioners, workers and small investors trying to understand why the financial statements gave no warnings; of public accounting firms being blamed or being charged for their complicity in the failures; and of government commissions convened to analyze such scandals and to prevent them from ever happening again.

Until recently, Andrew Fastow, the chief financial officer (CFO) of Enron, was the poster child for the accused white collar criminal.[1] The collapse of Enron reverberated throughout the United States and the world. Once the seventh largest corporation in the U.S., "Enron's collapse in late 2001 cost investors billions of dollars, put thousands of Enron employees out of work and wiped out retirement savings for many. The company, once admired, became a symbol of corporate greed and excess, and its fall was followed by a string of scandals at other companies" (Associated Press 2004).

More recently, Andrew Fastow has been superseded and replaced by other poster children. On July 9, 2004, federal prosecutors charged Kenneth Lay, the chief executive officer (CEO) of Enron, with eleven counts of conspiracy, wire fraud, and securities fraud. Although it was expected, the drama of seeing Lay, a close friend and financial supporter of President Bush, being led away in handcuffs served as an important sign that justice would be served. After all, exactly two years earlier, on July 9, 2002, George Bush had gone to New York City, the home of Wall Street, and given a speech stating that "The misdeeds now being uncovered in some quarters of corporate America are threatening the financial well-being of many workers and many investors. At this moment America's greatest economic need is higher ethical standards, standards enforced by strict laws and upheld by responsible business leaders" (Associated Press 2002).

Soon after the Enron scandal, the largest ever corporate fraud resulted in the bankruptcy of WorldCom Inc. The discovery that its profit had been overstated by $11 billion erased $180 billion from the company's market value. Recently the former CEO, Bernie Ebbers, was found guilty of fraud and sentenced to twenty-five years. Following the sentencing, the world witnessed the Edmonton-born Ebbers openly weeping in court and former employees and investors testifying to how much they had lost as result of the fraud. At the time of writing, Ebbers' lawyers are planning to appeal the conviction.

Closer to home, Canadians have their own poster children. During the 1990s it was Garth Drabinsky, founder of Livent and famous for the staging of musical spectaculars such as the *Phantom of the Opera* and for his ownership of Cineplex Theaters. Drabinsky was charged in 1999 by the Securities Exchange Commission of the United States for "engaging in a multi-faceted and pervasive accounting fraud spanning eight years from 1990 through the first quarter of 1998" (SEC 1999). At the time of writing, the Ontario Securities Commission has not yet been successful at getting Garth Drabinsky into court, as pre-trial hearings continue.

More recently, our very own Lord Conrad Black, controlling shareholder of Hollinger Inc. and a symbol of the Canadian entrepreneurial spirit, has been the target of an SEC investigation after an internal investigation revealed "$32 million in unauthorized payments to Black and other executives" (Taub 2003). Like the aforementioned poster children, Black has denied any wrongdoing. Meanwhile, the wheels of justice slowly grind forward in an attempt to uncover what happened. At the time of writing, the SEC has proceeded with a court case against Lord Black. More details of the case will undoubtedly emerge now that his colleague (David Radler) has pleaded guilty and agreed to cooperate with the authorities.

If images of corporate executives in handcuffs have captured our imagination, the public accountants involved have not escaped the glare of publicity associated with these financial scandals. Arthur Andersen public accountants, once the auditor and advisor to the corporate giants and once viewed as the crème de la crème of public accountants, have fallen as hard as, if not harder than, their corporate clients who have been charged with malfeasance. Following the spectacular failure of Enron and WorldCom, Arthur Andersen was charged with obstruction of justice for destroying audit documents pertaining to Enron, and as a result of this and other client problems, the firm was dissolved in 2002. Vice President Cheney was a big promoter of Arthur Andersen. As he stated in a 1996 promotional video for the firm, "One of the things I like that they do for us is that, in effect, I get good advice, if you will, from their people based upon how we're doing business and how we're operating, over and above… just sort of the normal by-the-books audit arrangement" (Gutman 2002).

Recently, one of the largest firms in the U.S. (KPMG) has admitted to selling fraudulent "Tax Shelters" to clients. Under these schemes rich clients avoided paying billions in taxes. To avoid a criminal indictment, the firm agreed to pay $456 million (U.S.) in penalties. Eight former executives, mostly former tax partners of KPMG, have been indicted. Under a deferred prosecution agreement, the firm will avoid charges as long as it commits no further wrongdoing during a three-year period of external monitoring. Although the Canadian KPMG partnership is a separate entity and is not directly involved, its reputation capital has been seriously affected.

The uncomfortable glare associated with these financial scandals has encouraged the public accounting industry, professional associations, individual public accounting firms and accounting academics to respond. These participants have sponsored commissions and think tanks, changed accounting regulations and promoted ethics as the solution to the problems associated with the financial failures. Starting in the 1980s, events such as bank failures, insider trading and other scandals not only resulted in intense scrutiny of public accountancy but also encouraged a revival of ethics. Centres for ethics, training programs, textbooks, company ethics videos, and on-staff ethics advisors, along with pronouncements by individual accounting firms and the professions themselves, are but some of the manifestations of this revival.

The theatre financial scandals — of corporate executives being charged, accounting firms being sued, government commissions being struck, and professional accounting bodies alternatively denying the responsibility of their members or introducing "reforms" that they argue will protect the public interest by resolving the problems once and for all — may appear to be a recent phenomenon; but history shows that the elements of the drama are not new. The play may end differently; corporate executives, for example, are now being led away in handcuffs, but the cycle of financial failures, government commissions and accounting reforms can be traced back in Canada to at least the early 1960s and has been performed periodically since then.

So how do we make sense of this theatre? Is it the case, as cynics claim, that public accountants are self-seeking and self-interested like the rest of the corporate world, and that they merely offer a form of window-dressing for greedy corporate executives? Or is public accounting, as defenders of the profession claim, a profession with high ethical standards, doing the best it can in the face of difficult and complex circumstances? Are public accountants driven by the profit motive, or are they seeking a truth in accounting?

The argument of this book is that it is impossible to answer these questions without examining the historical context in which public accounting evolved as well as the way that the public accounting profession has viewed itself and what it does. It is only through this simultaneous examination of the "business" and "calling" of public accounting that we can understand how the possibilities and limitations inherent in the practices of public accounting influence the ability of public accountants to protect the public interest and to prevent corporate malfeasance.

Starting from the early 1900s, we trace the historical trajectory of the Canadian public accounting profession, showing how the profession's image of itself and what it does has changed in response to the events of the day. This historical examination highlights the cycle of external crises and events that have influenced and even shaped the profession's image and understanding of ethics, as well as the notions of independence and objectivity used to guide auditing practices. In doing so, this analysis illustrates that public accountancy is simultaneously a business and a calling or public service; thus, to try to understand it in any other way misses the tension that is always present between these two faces of the profession. Indeed, it is this tension that encourages professional associations to try to "improve" accounting practice and that renders these efforts almost always inadequate to prevent the next round of financial scandals.

One of the difficulties of discussing public accountancy and the accounting profession is that there are at least two faces. Aside from being members of a profession in which character and personal ethics are important, public accountants are also in business — the business of offering services to the public, or at least a range of stakeholders. Units of accountants, organized as partnerships ranging from a small two-person office to a major multinational operation, are in business to make a profit for the partners. Here lies the central conflict with the ethics of public interest: the partnership must successfully sell and promote its services to clients in order to survive. At times, partners may feel the pressure to acquiesce to client requests that go against the public interest.

Does this mean that some other type of financial market regulation is needed? Perhaps, but our historical examination also illustrates that attempts by government to improve its regulation in the wake of financial scandals have not been any more successful than the attempts of the public accounting profession. Rather, financial failures and financial scandals continue despite the best efforts of government regulators and public accountancy associations. As we suggest throughout the analysis and in the final chapter, perhaps these financial scandals should be viewed as "normal accidents." This notion of normal accidents, which we discuss in Chapter 2, suggests that such events may be unavoidable given the structures and incentives inherent in financial markets. As with many social activities that involve organizations and individual stakeholders, unforeseen accidents will inevitably occur. Although some would like to regulate such activities in an attempt to eliminate fraud and other market failures, we believe that rules and regulations cannot prevent all system breakdowns and protect all stakeholders. The preparation of regular financial statements and the associated audit reports can and do prevent some of the worst fraudulent activities, but there will, in our opinion, always be some failures and frauds that will not be detected. Similar to the tension between the business and public service of accounting, normal accidents might also be the consequence of an irresolvable tension between the need to create spaces for entrepreneurial activity and the need to protect the public interest within financial markets. We return to this idea in the final chapter.

This is a book about the Canadian public accounting profession. But as the analysis and examples illustrate, it could just as easily have been a book about the United States (U.S.) or the United Kingdom (U.K.) public accountancy professions. While the organization and structure of the public accountancy profession and financial markets in these countries differ from those in Canada, the similarities are more striking. Furthermore, in this age of "globalization," public accountancy is never immune from the events and crises of other countries. Thus an analysis of the trajectory of the Canadian public accountancy profession not only provides a counterpoint to the experiences in other countries but also yields insights into the almost universal tension between the business and the public service of accounting.

NOTE

1. In most corporations, the Chief Financial Officer is most directly responsible for providing financial information to shareholders and other users. At Enron, Andrew Fastow appeared to be a master at removing necessary information from the financial statements and structuring transactions so that they would not appear in information revealed to shareholders.