CHAPTER 13

The Legitimacy Predicament of Current-Day Accounting Theory

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1 Background

The volatility, complexity, and ambiguity in the modern business environment present unique challenges for contemporary organizations. Among these are concerns regarding effective resource utilization, stakeholder requirements, and regulatory reporting. Furthermore, the accounting profession's reputation often comes under fire due to international corporate failures and corruption (Parker, 2007). It may be argued that since accounting translates an organization's performance into financial terms, accounting theory should embrace practical accounting realities. However, as a scientific discipline, accounting (theory) should be founded on principles of scientific rigor and not merely be focused on technical skill and application. Hence the objective of this study, which was to critically reflect on the legitimacy of foundational accounting concepts in (1)

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P. W. Buys and M. Oberholzer (eds.), *Business Research*,
https://doi.org/10.1007/978-981-19-9479-1_13

the context of the contemporary business environment and (2) what is promulgated as accounting theory.

Even though accounting has many specialization areas, the two primary foci areas are internally orientated managerial accounting and externally orientated financial accounting (Drury, 2018; Horngren et al., 2015). Within these two foci areas, financial accounting is subject to rules (i.e., financial standards and regulations), which guide how financial information is to be determined and disclosed. This research study focused on financial accounting, particularly on certain foundational aspects that may influence its application in the contemporary business environment.

In context, this chapter's primary aim is to elucidate *critical reflection* as a research methodology in accounting and share some of the experiences in conducting such research. Nevertheless, this will not be possible without discussing various aspects of the actual research and related conclusions.

2 Perspectives on Accounting

Considering the global developments in accounting over the past decade or two, there appears to be a problem of a lack of legitimacy in fronting business information generated by accounting. The prevalence of the importance of rule applications, a focus on financial performances, and the (perhaps short-sighted) reporting thereof are arguably responsible for the limited perception of its crucial societal role. In the context of the study's objective of reflecting on the (epistemological) aspects related to legitimacy concerns about accounting theory, this study reflected on certain foundational elements of accounting, including the following:

- Even though professional accountants must adhere to codes of ethical and professional conduct, the advent of fraud and corruption may arguably be seen as an attack on the historical stewardship function of accounting (Williams, 2009), raising the issue of what *actual* ethical accounting conduct requires.
- Even though the various iterations of the conceptual accounting framework aim to inform accounting practice and, to some extent, certain information user classes, it arguably seems to be more focused on meeting the accounting regulators' requirements (Fellingham, 2007), raising the question of what the primary foundational *objective* of accounting is.

- Even though the financial statements form the basis for communicating financial information (Palepu et al., 2007), the ability to approximate the values presented in the financial statements is typically the barometer of accounting methods' efficacy, raising the issue of what *actual value* is, at any given time, let alone how to measure it.
- Even though the objective of decision-usefulness is a common criterion to guide accounting research and support the formulation of corporate policies and strategies (Williams, 2009), considering the many corporate failures and fraudulent events, one cannot but wonder how trustworthy the financial information is in supporting decisions.

Taking cognizance of the above, the chapter firstly focuses on the study's research problem as the basis for the methodology selection before explaining the research design that follows. Finally, the research evidence and conclusions per the original study are also included to provide overall context.

3 Research Problem and Objectives

If philosophy is considered as the underlying principle for a particular discipline (Livingstone, 2008) and the rational inquiry into its principles (Blackbury, 1994), one may argue that a philosophical reflection on the legitimacy of accounting theory is overdue (Demski, 2007; Fellingham, 2007). The reality of contemporary accounting is a somewhat unique situation where practice and industry requirements significantly influence how its academic side is approached.

Because of this industry impact on the *science* of accounting, the research study's primary aim was to reflect on the legitimacy (or validity) of accounting assumptions, concepts, and objectives as promulgated by accounting regulators. In consideration hereof, certain meta-theoretical assumptions formed the basis of the study. Firstly, accounting is seen as (1) a method to gauge the organization's performance measurement, (2) aiming to reflect reality, and (3) as having predictive abilities. Secondly, the accounting information is representative of actual (resource) quantities and monetary values in the organization's context.

In support of the above primary research aim, several secondary research objectives in addressing the primary purpose were identified, as follows:

- Consideration of ethics in the practice of accounting.
- Consideration of a definitive accounting philosophy that embraces aspects such as accountability, integrity, and reliability.
- Consideration of the value concept in accounting from qualitative and quantitative perspectives.
- Consideration of the decision-usefulness concept to classify the purpose of accounting.

4 Research Design

4.1 A Reflective Approach to Accounting Research

As mentioned above, the study was reflective in nature. As such philosophical discussion and reasoning take center stage, as opposed to empirical data collection, analysis, and validation. In this context, the *Three Worlds Framework* per Mouton (2011) and Van der Schyf (2008) are used to contextualize the study and elucidate differences between research approaches. This framework classifies research levels as follows:

i. Lay knowledge required in ordinary tasks or ***pragmatic*** interest can be found in the *World I* domain.
ii. Research that converts the above lay knowledge into objects of inquiry or ***epistemic*** interest is found in the *World II* domain.
iii. Reflections on the motives and validations of specific actions or ***critical*** interest are found in the *World III* domain.

According to Mouton (2011), the latter domain (i.e., critical interest) includes multiple meta-disciplines, including that of scientific philosophy and methodology (Mouton, 2011). It is also generally accepted that scientific findings cannot irrefutably be demonstrated based on empirical research alone and that many (scientific) theories are often justified based on assumptions in the critical (or meta-theoretical) sphere (Mouton & Marais, 2009), including the research's underlying paradigms and models. This study, therefore, embraced a philosophical analysis of *accounting's* *meta-science,* per the research objective, and aims to lessen the constriction between the epistemic and pragmatic views of accounting.

4.2 Paradigm Perspectives

According to Lewis (2001) and Hazelrigg (1986), philosophical ontology denotes the study of reality or existence, which in turn can be categorized as either (1) objectivism, which argues that reality exists autonomous from consciousness (Hazelrigg, 1986; Henning et al., 2009; Lewis, 2001) and (2) constructivism, which argues that personal experiences are fundamental in constructing perceptions of the reality (Hazelrigg, 1986; Ladyman, 2002; Lewis, 2001). In the context of this study, the ontological view leaned toward constructivism and accepted possible misconstructions between the *perceived* function of accounting and the *reality* thereof in the contemporary business environment.

Furthermore, Mouton and Marais (2009) view the concept of a research paradigm as the principal model embraced when conducting scientific research. Conventional accounting research is arguably framed in a positivistic paradigm, with perhaps some aspects of interpretivism thrown in. According to Audi (2005), Blackbury (1994), and Rahi (2017) positivism embraces empirical inquiry as the singular source of essential knowledge. This implies that deductive reasoning is employed to postulate accounting theories. Interpretivism expands somewhat on positivism in that it aims to understand the research results in each context (Carson et al., 2009; Nieuwenhuis, 2020). Therefore, for research that seeks to understand the conduct of various role players, such as found in the complicated environment in which accounting finds itself, interpretivism may be appropriate to explore the complex reality effectually.

As an alternative to positivism (among others), a critical paradigm approach aims to deconstruct the reality under scrutiny (Henning et al., 2009; Kekeya, 2019; Probert, 1999). Carlsson (2006) opines that a robust research approach encourages the critical realization that reality will be understood only by identifying the structures that cause specific actions and the discourses therein. Therefore, although positivism and interpretivism are very much applicable in an accounting context, the integrated nature of accounting with business and social environments does imply that critical, reflective research can also significantly enrich accounting's claim as a social (business) science.

Henning et al. (2009) opine that qualitative paradigm researchers will typically apply approaches that are rooted in either:

- Philosophy that reflects on questions the constructions and crux of reality, known as ***phenomenology***.
- Sociology enquiries into how to make sense of daily activities, known as ***ethnomethodology***.
- Social psychology enquires about the environmental elements that cause specific actions and the subjective meaning attached to such details, known as ***symbolic interactionism***.
- Theology, philosophy, and literary criticism that considers the conditions under which a human activity took place, known as ***hermeneutics***.

At first glance, the above approaches may seem to be radically different. However, Mouton and Marais (2009) argue that in the context of social sciences research, there is plenty of opportunity for overlap between these approaches. A reflection on the legitimacy of contemporary accounting can thus be approached in any (or a combination) of these approaches.

4.3 Research Approach

The applied research approach comprised a combination of a literature overview and critical reflection. Firstly, the literature overview provided the foundation for understanding contemporary accounting theory, including frameworks, financial reporting, decision support, and performance management. Secondly, in its reflective endeavors to consider contemporary accounting theory's legitimacy, the research was positioned principally within the critical framework. To a certain extent, however, interpretive facets were included to enrich the discussions. Also, seeing that the study drew on accounting phenomena, including ethics, value concepts, and related factors, the research approach was primarily centered on phenomenology and hermeneutics. In this context, the research approach's justification is found in its challenging conventional accounting assumptions and perceptions.

The critical reflection also endeavored to evaluate accounting's ideas and beliefs, autonomous of conventional research experiences. As such, the foci were on foundational questions about logical explanations rather than the experimental research and concepts.

5 Research Evidence

Considering the lacunae regarding the legitimacy of accounting theory, the study aimed to recognize key accounting facets that may contribute to the discussion at hand. These facets include critical ethical issues, the foundational building blocks, the concept of value, and the decision-usefulness objective—all within the context of accounting theory and practices.

5.1 Ethical Considerations

Accountancy was historically understood as fulfilling a stewardship function. Even though the current objective(s) of accounting arguably may be seen as downplaying stewardship, it remains essential. Ethical conduct in an accounting context is encouraged by the various accounting institutes' requirement of observance of *professional conduct codes*. These codes are typically based on the following pillars:

- ***Competency*** requires adequate accounting-related technical skills.
- ***Integrity*** requires honesty and determination.
- ***Objectivity*** requires professional impartiality and detachment.
- ***Confidentiality*** requires refraining from disclosing and misuse of professionally acquired information.

Professional conduct can be defined as how a person dedicated to their profession acts. However, even though the accountant should avoid damaging the profession's reputation, ethical behavior further affects the accountant and other related stakeholders. It might, therefore, seem that the pillars mentioned above address the ethics issues in accountancy. However, when reflecting hereon, there are two sides to the coin. On the one hand, there is the aspect of doing *the right because of the rules*, i.e., the adherence to the codes of conduct. On the other hand, there is the aspect of doing *the right thing because it is the right thing*, i.e., a moral element. The latter can never be codified. Therefore, although professional codes of conduct aim to guide ethical behavior, the human condition will always be prone to temptation to the contrary.

Furthermore, of the typical four pillars of professional conduct, only the *integrity* aspect considers the human condition. In the context of the prevalence of corruption and ethical failures, the absence of integrity is arguably the primary contributor to letdowns in other areas of professional conduct. Historically, personal belief systems and family values played a significant role in professional conduct in any field. However, in contemporary and secular society, practicing accountants' interpretation of the accounting framework and the code of conduct is more based on contemporary education systems. Therefore, the profession, including educators, employers, and regulators, should emphasize the importance of avoiding even small moral failures.

5.2 Accounting Philosophy

The next aspect considered was the ambiguity in understanding accounting's primary purpose. The concept of Generally Accepted Accounting Practice/Principles (GAAP) was historically the overarching concept that guided and defined acceptable accounting practices and conventions (Epstein et al., 2005). In contemporary accounting, the idea of the accounting framework became the descriptive term when referring to the guidance of accounting practices. It also became the basis upon which the regulatory and professional institutes based their versions of accounting theory. Many scholars, such as Demski (2007) and Fellingham (2007), however, disagree with the presentation of a practice-based accounting framework as a scientific basis for accounting theory and argue instead that a proper foundation in formulating an accounting theory should rather be its ability to contribute to appropriate organizational performance conclusions. In fact, the contemporary business environment demands accounting information to support business decision-making. Therefore, a more definitive manner of formulating accounting theory should be based on acknowledging that accounting is inherently part of all aspects of the organization's economic sphere.

However, even though the organization is considered an integral part of society, it is also a separately identifiable economic entity. Accounting information is based on *value*, used to report the various components of financial statements. As such, the building blocks of accounting (and financial reports), i.e., the revenue and expense items and the asset and expense items, must be gauged, measured, and reported by each element's relative importance to the organization's overall performance. If possible, such reporting should be robust and not lead to intermittent re-valuation and adjustment. Re-valuations, by their nature, negatively impact the comparability of financial information between different organizations and reporting periods and could also negatively affect internal organizational department comparisons.

In conclusion, a definitive accounting philosophy should include three essential pillars. The first should point to the primary purpose of accounting information, which is to report the *economic events incurred* during the organization's business operation. The second should guide the provision of *valuable, relatable, and comparable information* about the organization's operational and financial performances, thus empowering the users of such information. Third, it should also facilitate understanding *the business decisions* made upon such information.

5.3 The Value Concept

Expanding on the above, the study moved into the domain of the value concept. The reflection acknowledges that the efficacy of many accounting techniques is gauged by their ability to approximate the value of economic and operational events. This, however, is not as simple as may be initially thought. A standard and generally accepted understanding of what the term *value* infers is problematic—never mind how it is to be determined. The study approached this dilemma from two perspectives, as follows:

- **Quantitative perspectives**: It was acknowledged that a critical objective of accounting is to translate the organization's operations and performances into financial terms. Furthermore, such quantified information must be made available in financial reports that are relevant, reliable, and comparable. The concern, however, is *how* the organizational operations and performances are quantified; in other words, how is it valued? The way in which accountants such values (information) determine may substantially impact relevancy, reliability, and comparability. In some sense, the quantitative value of the operational and economic events and their results can be seen as a judgment of resource scarcity. Such valuation judgments, however, can be approached from varying perspectives, including the technique and purpose thereof. In context, current accounting guidelines are moving toward so-called fair-value-based measurement and reporting techniques. There are, however, apparent concerns regarding the inconsistency and partiality characteristic of many valuation techniques. Nonetheless, irrespective of whether historical cost or fair-value-based principles are better, the crux is that the generation of accounting information must remain focused on the relevancy, reliability, and comparability aspects of reporting organizational performances.

- **Qualitative perspective**: It was acknowledged that *ethical* accounting behavior is more than professional conduct, competence, and adherence to codes. In this context, the value can also refer to a value system, and as such, the *moral* application of ethical guidelines is key to ensuring the organization's operations are socially acceptable. Stewardship is a somewhat prickly matter in contemporary accounting, and its value is often downplayed by the accounting focus on supporting the capital providers—which is just one stakeholder class. Nevertheless, the principles of stewardship must remain central because of the vital role accounting fulfills in recording and reporting the consumption of resources and the resultant distribution of the created value. Therefore, the concept of value and what is perceived to be of value have different connotations for different user classes (stakeholders) of the financial information resulting from the accounting processes.

In the context of reflective studies in typically quantitative disciplines, the difficulty is arguably therefore in being able to identify qualitative aspects within said discipline and then trying to enrich foundational aspects thereof.

5.4 Decision-Usefulness

The decision-usefulness concept has been central in determining accounting policies and practices *REFERENCE. It has also been foundational in countless accounting research projects for many decades. Nevertheless, there has also been some resistance to a vacuous decision-usefulness concept as critical to accounting and financial reporting practice (and theory). The study, therefore, reflected on whether decision-usefulness is an unquestionable way to justify and guide the practice of accounting rationally. A key concern is that the accounting regulators give so much preference to the utility of the capital providers, as a stakeholder group, that a principal function of accounting became the provision of information primarily valuable for them.

Without clarification of the type of utility being sought from the financial reports, vague insinuations about the *usefulness* of accounting information are without merit. The study approached the issue of decision-usefulness objective from two angles, as follows:

- Firstly, from an ***ontological*** perspective, the application of accounting methods was reflected upon from the perspective of the allied concepts of *utility* versus *ophelimity*. Whereas the former is a broader value concept that assumes a value concept for a wider audience, the latter assumes independent individual values. Therefore, by focusing on the decision-usefulness objective as it is currently focused on the capital providers, the regulators are arguably not concerned with the greater good of social utility but rather on focused individual ophelimity. This may be considered as being subjective and biased toward ordinal economic gratification.
- Secondly, issues around the quantification of accounting data and its predictive abilities were considered from an ***epistemological*** perspective. It can be argued that the accounting information presented in financial statements is often not representative of an absolute *quantity*. Instead, it is the result of summarizing techniques that provide a window into a more complex qualitative situation. Therefore, accounting should only be seen as a measurement activity in providing a rough estimate of reality. In respect of the question of prediction, the study argued that the reported accounting information is unlikely to possess any actual predictive ability for two reasons. On the one hand, information users have different objectives when they use such information against different backgrounds. Therefore, no single report of financial information in a specific format would be able to meet the unique individual requirements of users, even within the single group of 'capital providers.' On the other hand, the market actions and reactions that the financial statements are supposed to help in predicting future economic events and trends operating in such a complex and dynamic environment, with many

> variables and divergent market forces, that it may very well become an impossibility to claim any predictive ability.

Therefore, although the study does not reject decision-usefulness criteria out rightly, it does caution against vacuous promulgation of decision-usefulness, lacking any substantive significance.

6 Research Conclusion

Aside from the debate as to who the real users of financial accounting information are, the debate as to the pros and cons of various accounting methods and techniques, or even what accounting theory entails, the reality is that the practice of accounting has a clear and deep-seated impact on (1) how it is taught and (2) on multiple societal levels. As such, accounting should be seen as part of the broader social sciences. However, the academic (scientific) aspect should also be such that it contributes to academia and not merely be seen as focusing on the training of accounting artisans. The summative justification of the accounting science foundation is elucidated below.

In the context of the study's focus on accounting theory's legitimacy concern, it is important to acknowledge the relationship between accounting and philosophy. If the concept of the *philosophy of science* is seen as the consideration of, or reflection on, aspects of the application of science, then accountants should not embrace such reflection. An argument could be made that it may be better for accountants to attempt such reflection in formulating quintessential accounting theories than it is for philosophers to attempt accounting reflection. Demski et al. (2002) opined that it should be easier for aspirant accountants to master aspects of philosophy as part of their accounting education. In such a manner, accounting (as a discipline) may then offer the context in which a quintessence of an accounting philosophy may be defined. This may also prevent accountants from being seen as dilettantes throwing around 'meaningless' words as a way to dabble in academia.

It will only be able to classify accounting as a social science if the discipline (professions) itself acknowledges such. This would, among other things, mean that research in accounting must at least follow scientific rigor. Considering the principle on which contemporary accounting regulations are founded, flawed as it arguably may be, it is evident that there is at least some scientific reasoning behind its postulates. Accounting is in a somewhat tenuous position in which the industry requirements play a significant role in how it is taught and researched. Furthermore, accounting is arguably in a similar situation in that research and practice are guided by *laws and regulations* and that normative research in accounting could enhance its scientific stature. Nevertheless, accounting is more than only the record-keeping function of economic transactions; it has widespread significance and influence on multiple spheres of society.

In conclusion, ethical failures in accounting will inevitably occur, just as in any profession where human judgment is a reality. Should this happen, the profession should not ignore such instances but acknowledge and reflect thereon and be open-minded enough to be pragmatic about the realities, noting that ethical and moral values are crucial to the profession. Although failures will occur, they should not detract from the profession's scientific legitimacy. In this context, we include the accounting profession. Furthermore, in any profession, many practitioners focus on their careers in industry, and they are less concerned with the scientific status of their chosen profession. This, however, also does not mean that the specific profession is not based on science. Again, this is very much also the case for the accounting profession.

Finally, perhaps the most significant aspect against the legitimacy of *accounting theory* is its decision-usefulness objective, including any claims of predictive abilities. Too many complex variables impact the information and users, so any claim of decision-usefulness (even for an exclusive and precisely defined user group) is nonsensical.

7 Concluding Remarks on the Research Process

A constraint of reflective studies is that the final reaction to problems is often not found. Nevertheless, answers (or solutions) to problems are not the only reason to undertake research. Reflective research aims to contextualize contemporary issues within a *bigger picture* and to get a debate going. This was very much the objective of this study.

A further limitation in undertaking reflective studies in a typically quantified discipline such as accounting is the objectivity of the disclosed financial numbers; the quantitative techniques and the statistical analysis are lost. In such instances, there is more room for subjectivity and bias to raise its head. Any reader of such studies should, in turn, take cognizance of such possibilities. Although every effort has been made to remain as objective as possible in this study's evaluation, interpretation, and reflections on the issues, the researcher remains human. As such, personal beliefs, opinions, and biases may be present.

Disclosure Statement This chapter is derived from the following research project: Buys, P.W. (2012). *The legitimacy predicament of current-day accounting theory* (PhD thesis). North-West University.

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