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Dear Investors: I Am Good at What I am for, Accounting Says

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Abstract

The advent of corporations has brought into existence a class of society's members who are not active in the day-to-day operations of their corporation. Corporate accounting fails to represent the economic reality underlying the corporation due to the inadequacy of the accounting structure to form accounting representativeness. The corporation is a fiction, and the shareholders' ownership is a myth. Accounting is to make myths [130]. Equity culture in ownership society has founded individuals who take risks with the executive management by holding the corporation's shares. Metaphorically, they can be viewed as 'gamblers.' When accounting users' needs were to control resources, accounting was an effective and efficient technological craft to meet such needs. On the contrary, when users of corporate reports are made up and their needs are imaginary, corporate accounting is incapable of constructing a reality reflecting the underlying economic reality of a corporation. Over a century of attempts to decide upon the content of corporate reports shows the impossibility of such a task. Therefore, corporate scandals are not outliers in a corporate economy.

Keywords: Corporation; Shareholders; Fiction; Myth; Risk; Reality; Accounting role

Introduction

"Accountants, in their way, are the wisest of men."

H. L. Mencken 1928, 33 as quoted in Goldberg 1965, 3.

Nobody knows the moment when accounting was first used or invented, leaving a lone individual to know who invented it. Certainly, accounting has emerged as a response to society's needs and has kept adopting roles across civilizations that have displayed advanced economic systems [3,11-14,20,25,28,43,47,50-52,57,66,79,100,102,112,151,153] (Belkaoui, 1995, Hopwood, 1987; Montgomery as cited in Nelson 1949], which assures its sustainability as a profession humanity depends upon [17].

The emergence of corporations where management is segregated from its owners (Berle & Means, 1932) has brought into existence a segment of our society characterized by the absence of day-to-day operations of their corporations [112]. At one point in time, Langendefer (1987) called them 'gamblers.'

Apparently, the corporate model for conducting business has been a discouraging undertaking for accountants [3,13,14,15,20,25,112,119], calling for the need to theorize the corporation from an accounting perspective [3]. What cannot effectively and accurately be theorized may not be well served. A corporation might therefore be addressed speculatively.

To date, accounting has not yet developed a theory for its own to specify the content of corporate reports [3,4,8,9,10,14,15,16,17,20,24,25,26,27,37,39,44,52,55,73,74,90,93,99,136]. In a 485-page volume, Riahi-Belkaaoui (2019) proposed an information cure for investors. The Cure contains chapters dedicated to what to disclose about aspects of the corporate model. While the contents of corporate reports are not yet decided, corporate reporting models have been proposed throughout time by accounting professional bodies, academic organizations, and individual academic accountants and professionals [121]. US corporate reporting is the most complex system (White et al., 2001).

For decades, the accounting discipline has been based on theoretical foundations such as the artificial persona, institutional theory, or agency theory. Dependency on other disciplines threatens the self-governing of the discipline (Mattessich, 1972). Some accounting academics doubt the disciplinary status of accounting (e.g., Demiski, 2007; Flellingham, 2007).

Theories that were imported from other disciplines to assist the accounting practice in effectively activating the corporate report function and accounting research in explaining observed phenomena in corporate reporting have not been sufficient. A great deal of accounting ambiguity leads to the conclusion that future accounting scandals are inevitable (Elkhashen & Ntim,

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2018). Corporate scandals continuously hit the world economy at various magnitudes. To some extent, accounting and auditing have been accused of not doing proper accounting and auditing. The public questioned, "Where was the independent auditor?" (US Congress, 1976, 7) when a corporate collapse hit their corporate economy. "Many believe that the failure of auditor independence has contributed to the collapse of corporations, the loss of jobs, and a widespread lack of trust in the US financial system" [36]. That is because "[w]hen an accountant signs his name to an annual report, a lot of investors, widows, and retirees place trust in the name" [41]. Auditing is unsafe for social life [18]. Power (1997) articulated, "the risk of audit is not simply that it does not work and leads to fatal remedies, although one can assemble evidence for this. Rather, it is that in the process of continuous movement and reform... it generates, it is also impossible to know when it is justified and effective. In essence…audit has put itself beyond empirical knowledge about its effects in…favor of a constant programmatic affirmation of its potential..."

The accounting profession and the auditing function may not meet public expectations. Several studies proposed competing models for auditor independence for conceivable cures [14,63,64,123,124,125,142] as a consequence of doubting the ability of the auditing function and its claim of objectivity (e.g., [2,14,23,30,34-36,46,63,64,77,94,95,103,106,110,111,114-116,122,132,143,145,146].

This paper sheds light on differences between individuals who hold shares of public corporations and are present as well as aware of the day-to-day transactions of these businesses and those who buy shares, either to hold shares for the sake of collecting dividends or to resell when the held shares are appreciated by the market participants. This paper stresses that accounting for controlling purposes has not failed to serve business enterprises' stakeholders in any model organized for conducting business (Rornem, 1930, 3-6, as quoted in Goldberg 1965, 66–67). Accounting is sustainable [17].

Still, Not Defining What to Account for

The corporate model for conducting business is probably the most controversial business model in accounting and the most debated contract in the law. The corporation is fiction [78,88]. The law gives it existence, yet it is still debating its justification. Reading Davis (1897) and Kornhauser (1989), Al-Adeem (2017a) concluded that over a century of corporate theorization does not differ from the initial attempt. Contradictions between the theory of the firm and corporate law exist [86], calling for reconstructing corporations [87].

The views of the corporation in accounting are not revolutionary [42]. The corporate person and the economic theory of the firm occupy accounting [141]. The nexus of contracts is nearly the contemporary dominant view of corporations [68] as well as in accounting [85].

Several characteristics distinguish publicly held corporations as a model for conducting businesses from other business models. Corporate debt is uninsured by the personal wealth of the stockholders, who are the *supposed* owners of their corporations. The corporation operates in a society financed by stockholders and debtholders while managed by professional managers who are not their owners. Corporations' operations are uninsured in case the corporation defaults and is unable to pay its debt. Debtholders and other corporate creditors can best claim liquated assets. *Imaginary* owners' ([13,16] personal finance is insured. The owner is holding what can be viewed as a call option. In a worst-case scenario, the owner loses the par value of his shares. Textbooks in finance stress this fact. For example, Ross et al. (2002:10) illustrate,

"When the value of the firm exceeds the amount of the promised debtholders, the shareholders obtain the residual of the firm's value over the amount promised to the debtholders, and the debtholders obtain the amount promised. When the value of the firm is less than the amount promised to the debtholders, the shareholders receive nothing, and the debtholders get the value of the firm."

What a corporation is may not be fully known. It exists in the mind of the law [88]. Its shares are unredeemable by the shareholders. The exception is treasury stocks, which the company might eliminate for a variety of reasons. Otherwise, ownership of the shares is transformable in the capital market. Not until a corporation is liquidated can the shares be terminated [88].

The Shareholders' Ownership Myth:

Where ownership in a corporation is dispersed, individual shareholders cannot control management (Ross et al., 2002). A board of directors might not be as effective as it might be thought [8-10], including audit committees [1] and external auditors [2,11].

Aspects of the corporate model have been viewed as mythology [49]. The myth of shareholder ownership has been argued in the literature [82,105,138,139] as well as the accounting literature [49]. The sociology literature by Clemens (2005) and Dobbin & Zorn (2005) calls for an end to such an ideology [71]. Building on Bebchuk's (2007) [2] argument, Stout labeled such a myth "the dumbest idea ever [3]". Claiming ownership of publicly traded corporations as a means of keeping their stocks for seconds [97,133] is arguably frolicsome.

Since the publication of *A Statement of Basic Accounting Theory* (ASOBAT) (1966), 'decision-usefulness' has emerged as a theoretical concept in the structure of accounting theory [136]. It is added to the already recognized six theoretical concepts [20,39,52,75,80]. Such a theoretical concept appeared in accounting at least as far back as 1961 by Davidson & Trueblood. Decision-usefulness is narrowly defined (Nurnberg, 2015; Horgans, 1981), and users of financial statements are imaginary [13,154].

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) adopted the theoretical concept of decision-usefulness in their professional pronouncements and official statements; the decision-usefulness ideology has been utterly criticized [13,15,17,29,67,107,118,150,154] (Horngren, 1981; Macve, 1981; Nurnberg, 2015).

Empowering shareholders is yet another myth. Current mechanisms enacted, for example, the Sarbanes-Oxley Act of 2002, might not be as effective as hoped (Al-Adeem, 2015; 2022a; Dent, 2010). Shareholders are weak in comparison to powerful managers (Roe, 1994; 2000). Equity culture exists in the corporate economy (Smith, 2006) to become an "ownership society" (Chabrak, 2011) that has caused a social shift in the US. In seeking freedom and democracy instead of depending on their government, such a public became investors instead of savers (Davis, 2009).

Corporate Accounting Is Not About Reporting Truth:

Accounting is not a science (Stump, 1981) but a social science [109]. Accountants who wish to figure out reality should benefit from wide-ranging theoretical frameworks from the social sciences [74]. Still, in the social sciences, 'absolute "truth" is forever impossible' [92]. One can develop a perception of what is believed to be real [4 Plato, 427–34 BC, as cited in Graham 2006, 99). Quantifying perceived realism objectively [7] is unbearable. Reality can be viewed as a social construct [144]. Observing the shadow of something or someone is not an indication of what is intended to be observed (Plato 427–34 BC, as cited in Graham 2006: 99).

Accounting ciphers are not imitations of reality (Macintosh et al., 2000, p. 16, 30, as cited in [74]), nor does accounting data reflect accounting-related reality (Sterling, 1988). Accounting entries do not correspond precisely to economic events because they move away through the dimensions of timing, recognition, and measurement [3,8-10] (White et al. 2001: 2). Several accounting writers have been concerned about the truth in accounting [106,120], the truth about corporate accounting [31], and the truth about auditing corporate reports [56].

Accounting reality is constructed [81] by accountants. Accounting representation of economic reality is impossible because of the insufficiency of the accounting framework to construct accounting reality (Elkhashen & Ntim, 2018). "[A] mbiguity and wishful thinking about how closely accounting numbers correspond to "economic reality" had no place in accounting" [45]. "… [A]ccounting presents conceptual and practical limitations with regard to the measurement of income and capital" [74]. Accounting income has neither a scientific base nor an empirical reference [91]. The "Generally Accepted Accounting Principles (GAAP)" are the accountants' "truth" (Previts, as cited in [3]), upon which the current conceptual construction of financial accounting is based and that presumably serves external shareholders. The financial reporting system remains imperfect [149], and hence "accounting information does not permit making true statements" [74]. Corporate and financial statements are produced by such a system. In some instances, financial statements deliver "no real economic value… [yet] fooled certain naive financial statement users" [33].

The Reality of Investing in Corporations: A Pragmatic Viewpoint

Investing in the capital market comes with the risk that corporate reports may not reflect the economic reality of the entity. Another risk is that executive managers are incentivized to report information in reports that best serve their own interests at the expense of shareholders [59,89]. Investors in a corporation's shares are virtually absent from day-to-day operations and most likely from governing their corporation. Their interests should be represented, and their interests should be guarded by the external auditors whom the management hires or has influence in hiring. Recent corporate governance regulations mandate that the audit committee deal with the external auditor and that the board of directors govern the external auditor's affairs while providing audit services. However, executive managers are arguably present in auditor selection and affairs related to audit fees and audit work [211,]. Therefore, investing in a corporation's shares is to take a risk with the executive management operating the company, running its day-to-day transactions, and planning to do so strategically.

In addition, the possibility of committing fraudulent actions in their reports to the public is yet another risk. With the presence of an external auditor, corporate reports cannot be fraud-free. In their critical analysis of the system of fraud in corporate reporting, Bayou and Reinstein (2001, 383) stressed, "Fraud can never be totally eliminated from society by the endless greed and chaos that rule every-day life."

External auditors have their own incentives to cooperate, at least in theory, with the executive management in ways that may not be in the best interest of the absent owners [2,14]. Hussey (1991) acknowledged the fear that the external auditors perceive the corporation as a client but not as stockholders. Appointing an external auditor by shareholders is a legitimate fiction [113]. A corporation is an institution with multiple stakeholders. Naïvely is to think that it is managed for only maximizing the wealth of shareholders. Some participants hold publicly traded companies' shares for seconds [97,133].

Stockholders need to bear the risk of financing the operations of the corporations in which they invest. They can depend on financial analysts. Financial analysts are part of corporate institutionalization [72]. They provide the capital market with recommendations about the traded shares. Participants in the capital market possess the freedom of choice to act upon their recommendations or not.

'Accounting societies and businesses for' *controlling* purposes in societies where business owners were present in their businesses. Even when agency was an issue among partners in joint ventures [32], trust was the remedy. Accounting probably is not designed to serve when the financer of the business is absent. Debtholders are historically absent from the operations of the entity to which they lend their money. They, however, keep watching the entity. In some cases, they impose restrictions on the entity in the form of debt covenants to guarantee that they get their money and interest. In contemporary corporations, debtholders sign debt covenants with corporations that can restrict the executive management from selling the crown assets of the corporation.

Investing in the capital markets gives the executives power over the public wealth and savings. Concentrated money in their hands provides them with power. A segment of controlling elites, namely owners and executives of a few houses, has materialized [59]. Commenting on Davis (2009), Chabrak (2011:5) stated,

"The "democratization of ownership" is a fiction. Financial investment is channeled through intermediary institutional investors such as mutual funds, which control more than three-quarters of the average large firm's ownership since 2005. If democracy exists on the market, it is certainly not direct but representative, leaving the destiny of the whole society in the hands of few market lords."

Concluding Remarks

Studying the nature of accounting suits Goldberg's (1965: vii) count that no final answer is yet available.

Working through others is neither an issue nor new to the business world. "…[M]erchant usually contracted agents instead of doing the trading themselves." [140]. When owners existed in the business in which they invested their wealth, accounting assisted them in controlling resources and holding agents accountable (Al-Adeem, 2024).

A limitation of this study is that I have not “read everything apposite and relevant to” (Goldberg, 1965: viiii) the nature, role, and function of accounting. While Goldberg (1965) restrains his well-researched and well-written monograph that the American Accounting Association chose to publish by not reading everything, such a limitation suits this article as well.

Studies on the nature of accounting are “never really finished; it merely reaches a stage when it has to be pushed out into the world for criticism, amplification, and modification”, Goldberg (1965: viiii) once stated. Hence, accounting researchers are encouraged to criticize this article to broaden the argument, hoping that we come up with an understanding of what accounting is capable of doing to best serve society.

Author Statements

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