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The Relevance of Critical Accounting Theory (CAT) to Effectiveness of Public Financial Accountability in Emerging Economies

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Abstract

In the past, researchers of financial accountability have relied on Agency and Stewardship theories to explain the phenomena that may hinder the exchange of financial information in the accountability process. This article examines the relevance of CAT to effective public financial accountability.Public sector in developing countries has accountability mechanism that is based on agency model. Accountability mechanism following the assumptions of principal-agent theory will most likely focus on monitoring procedures in order to reduce information asymmetry. This can enhance the disclosure of information but may result in an information overload problem on the part of the accountors' and the accountees. Extant literature asserts that the theory is not an appropriate framework for contractual services that are difficult to be measured and observed, and that the theory fail to address the issue of relevance of environment, competition, management capability, and availability or lack of strong incentives, particularly financial, for aligning an agent's actions. As research in public financial accountability emerged, the issue of the most appropriate theoretical framework to adopt remained unanswered. Critical Accounting Theory (CAT) is gaining wider acceptability among scholars in their quest to address the problem of the conflict of goals between the principal and the agent and the difficulty or the inability of the principal to verify what the agent is doing.Extant literature established the paucity of studies on critical accounting literature that focus on developing countries.This theoretical paper exalts CAT and its relevance to modern day developing societies.

Key words: Accountability; Critical Accounting Theory (CAT); Public financial accountability; Principal-agent theory; Culture; Accountee; Accountor.

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INTRODUCTION

As research in public sector accounting developed, the issue of the most appropriate theoretical framework to adopt remained open (Jacobs, 2012). It is the view of researchers of accounting theory that the present is not satisfactory, "that reality could be better than it is" (Laughlin, 1987, p.482), and it is this position that so clearly distinguishes critical accounting research from traditional agency and stewardship research.In the past, researchers of accountability have relied on Agency and Stewardship theories to explain the phenomena that may hinder the exchange of financial information in the accountability process (Greiling & Spraul, 2010; Caers et al., 2006; Davis et al., 1997a) .Investigating the socio-political context and implications of accounting and accountability systems (AAS) has been the central focus of critical accounting (Brown & Dillard, 2013).

In view of the current limitations of accounting research Lehman (2006, p.761) ask that 'how does accounting and accounting research contribute to the derivation of good decisions?"– Or the avoidance of bad decisions? The answer according to Gray (1992) lies in communitarianism, engagement and a move from processual accountability towards the development of more personal and organic accounting that involved closer personal and spiritual contact and less distance and formality that have characterized traditional accounting research.

According to Rahaman (2010), there is paucity of critical accounting research that focused on Africa:

> Today, three major research outlets; Accounting, Organizations and Society (first issue in 1976), Accounting Auditing and Accountability Journal (first issue in 1988), and Critical Perspectives on Accounting (first issue, 1990) are flagship journals for this genre of research. Together these three journals have published approximately 2,374 papers, as of February 2009, averaging almost 100 papers annually, only 24 articles relate to Africa. However, a careful content analysis reveals that the advanced Western capitalist countries constitute the prominent empirical realm of the current critical accounting literature. For example, since its inception in 1990, Critical Perspectives on Accounting has published 651 articles in 108 issues, of which only nine articles are focused specifically on African issues. (Rahaman, 2010, p. 420)

1. IN THE NEXT SECTION THE AUTHORS WILL DISCUSS THE CONCEPT OF FINANCIAL ACCOUNTABILITY AND THE IMPORTANT OF CULTURE TO FINANCIAL ACCOUNTABILITY

1.1 Financial Accountability

Financial accountability is about stewardship of public money; a mean of ensuring that public money has been used in a responsible and productive way, it is about verification of legality and regularity of financial accounts and also ensuring that value for money has been achieved in the use of resources (Rabrenovic, 2009). This relates to the control and elimination of waste and corruption and involves compliance with legal procedures, as well as the use of external audit mechanisms (Davies & Polverari, 2011). It is the obligation of any one handling resources, public office or any other positions of trust, to report on the intended and actual use of the resources or of the designated office (Adegbite, 2010).

According to Rabrenovic (2009), the financial accountability relationship established between the government and the citizens is in many ways problematic, the reason for this is the practical impossibility of close and detailed scrutiny of the government's actions by the citizens. This situation has brought about a need for the introduction of third actors in the accountability relationship – representatives or/and professional bodies, which would, on behalf of the citizens' provide indirect supervision of the executive.

According to Sahgal and Chakrapani (2000) manifesting financial accountability is therefore much more than building and maintaining accounting and auditing systems. It represents more than just the technical capability of financial managers. Financial accountability is not complete until it encompasses the wide-ranging activities, attitudes, and reporting relationships between all stakeholders.

1.2 Culture

The significance of culture in influencing and explaining behaviour in social systems has been recognized and explored in a wide range of literatures (Choi, 2002; Hofstede & Hofstede, 2005; House et al., 2004). An organization's culture consists of a set of shared values, goals, and ideals, norms for behaviour, and cultural "symbols" that govern the behaviour of individuals. Hofstede et al. (2010) postulates that the environment within which accounting is practised will determine the structure of the resulting accounting system. Culture is an important variable affecting a country's accounting environment and research in different countries have enhance the awareness of the important of environmental factors in moulding a country's accounting and accountability system (Choi, 2002). Goddard (1997) research provided empirical evidence that when a financial control system is incompatible with organisational culture, it will meet resistance and eventually fail. He also found correlation between organisational culture and budget-related behaviour, particularly with respect to budgetary participation and the usefulness of budgets to support the managerial role. Licht et al. (2007, quoted in Daniel et al., 2012) also demonstrated that institutional norms related to law, corruption, and democratic accountability correlate strongly with national cultural dimensions.

A conceptual framework showing the relationships that exist between financial accountability, culture and accounting infrastructure is presented in Figure 1.

a. Financial Accountability – its effectiveness enhances good governance.

b. National Culture – culture of openness or secrecy; uniformity or flexibility and professionalism or statutory control influences the effectiveness of financial accountability.

c. Accounting Infrastructure – nature of accounting personnel, financial management information system and public sector accounting and auditing standard influences the effectiveness of financial accountability

The effectiveness of financial accountability will depend on the effectiveness of the budget process, financial reporting system and audit process. Where there is effective financial accountability characterized by an effective and transparent budget process, accurate and timely financial reporting and effective external oversight, there will be transparency and openness on the part of elected officials and the managers. On the other hand if there is poor budget process, financial reporting and ineffective external oversight, there will be corruption and mismanagement which will leads to poor performance. According to Rahaman (2010) accounting does have a critical role in Nigeria and other emerging countries because of the widespread documented instances of corruption and financial mismanagement both in the government and private sectors.

In the next section the theories of financial accountability is discussed. The development of theories over the decades plays an important role in the development of financial accountability framework for public sector.

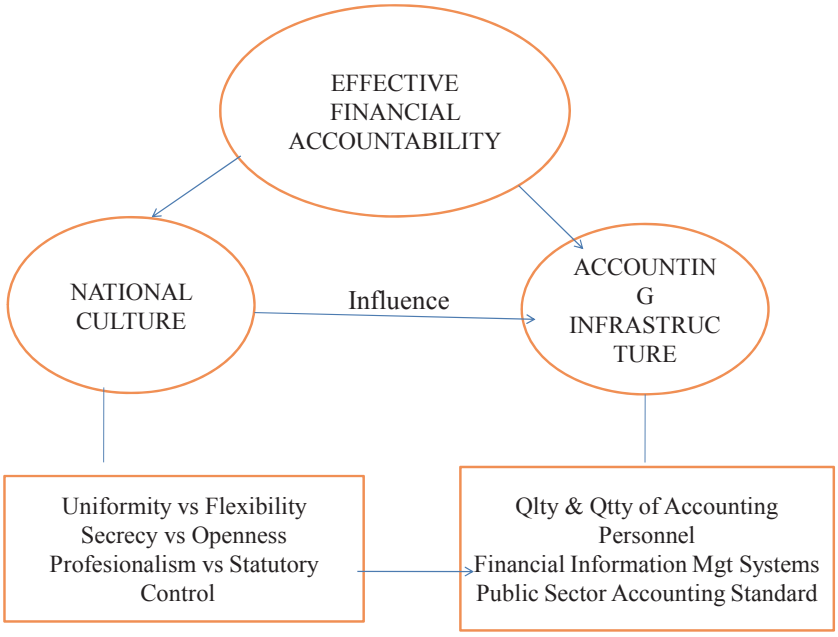

Figure 1
Conceptual Framework of Financial Accountability, Culture & Accounting Infrastructure (FACAI Model)

2. THEORETICAL FRAMEWORK

In the past, researchers of financial accountability have relied on Agency and Stewardship theories to explain the phenomena that may hinder the exchange of financial information in the accountability process. Nigeria public sector like other emerging economies has accountability mechanism that is based on an agency model. Accountability mechanism following the assumptions of principal-agent theory will most likely focus on monitoring procedures in order to reduce information asymmetry. This can enhance the disclosure of information but may result in an information overload problem on the part of the accountors' and the accountees (Greiling & Spraul, 2010).

2.1 Principal-Agent Theory

Agency theory describes strategic interactions between two parties, called the principal and the agent (Halachmi, 2004). The agent acts on behalf of the principal; with the assumptions that the actors are utility maximisers driven by self-interest who act in situations of bounded rationality and normally differ in their aversion to risk (Eisenhardt 1989). The theory assumes that the principal's access to information is limited, and that the principal cannot perfectly and without costs monitor the agent's actions (Jacobides & Croson, 2001). Principal-agent theory is concerned with the problem of the conflict of goals between the principal and the agent and the difficulty or the inability of the principal to verify what the agent is doing (Eisenhardt, 1989).

The relationship between the actor (accountor) and the forum (accountee) is often interpreted as one between agent and principal (Bovens, 2007b), this is not only true for economics but also for political science (Greiling & Spraul, 2010). In democratic system, representative democracy means that popular sovereignty is exercised through delegation from citizens to elected representatives. The executive and the legislature are seen as agents in a chain of delegation whereas the citizen is the ultimate principal. It is the responsibility of the agent to inform the principal about current or planned behaviour and actions (Bovens, 2007b).

Despite the fact that agency theory is an inappropriate framework for activities or services that are not easily measured and observed, the theory has been usefully applied to understanding a variety of organizational phenomena (Van Slyke, 2006). The theory has been suggested as a conceptual foundation for examining the vertical relationship between the government (agent) and the public (principal).

2.2 Tenets of Agency Theory

According to Van Slyke (2006), the main tenets of agency theory focus on information asymmetry (when one party has information the other party does not possess); pre-contractual opportunism (when one party knows more about attribute of a product or service than another and, as a result the uninformed party runs the risk of purchasing

a product or service of low quality), and moral hazard or post-contractual opportunism (when a party to the contract uses information and expertise and act in its own self interest, to the exclusion of the agreed upon goals).

When the agent's behaviour is not controlled or restrained, the goals of the principal are unlikely to be attained; to counteract the agency conflicts that principal-agent relationship may bring about, theoretical research has focus on mechanisms that may help the principal to control his agent (Caers et al., 2006). This is the reason why CAT is receiving much attention from accounting researchers.

2.3 Stewardship Theory

Within the broader concept of corporate governance, stewardship theory has been developed as an explicit counterpart to principal-agent theory. Stewardship theory which develops from organizational psychology and organization sociology serves as an alternative to the reasoning of principal-agent theory (Donaldson & Davis, 1991).

Stewardship theory fails to consider the lack of trust within government agencies, the risk-averse dispositions of public managers and the lack of incentives for public officers; the deeply politicized environment and scrutiny for oversight and accountability create pressures for not developing trusting relationships because of external perceptions of corruption (Van Slyke, 2006). According to Sinclair et al. (2009) stewardship style of governance is only relevant for small organizations; stewardship model is incapable of meeting the equity needs of all stakeholders within a large organisation. Study have showed that stewardship theory has not been tested particularly in voluntary sector research and public sector, and the enthusiasm with which some of its proponents advocate this approach makes their claims seem too good to be true (Cribb, 2006; Van Slyke, 2006).

Greiling and Spraul (2010) assert that stewardship theory delivers a theoretical critique but also fails to provide any empirical evidence for accountability in the public sector.

2.4 Critical Accounting Theory (CAT)

Critical Accounting theory focuses explicitly on the reasons for unintentional reluctance to provide information; in contrast to principal-agent theory or stewardship theory, CAT does not focus on the tactical or strategic unwillingness of the accountor to give a full account, but rather on his or her inability to do so.

In their article, Accountability and The Challenges of Information Disclosure, Greiling and Spraul (2010) examines two phenomena that may hinder the exchange of financial information in the accountability process, these includes the reluctance to disclose relevant information and deliberate and intentional information overload. The paper builds on the assumption that too much or too little information can be a challenge for public sector financial accountability. They believe that until now the problem of reluctance to disclose information has been addressed in the accountability literature only as a secondary topic or by using only one theoretical framework, mostly principal-agent theory. To overcome the problem of reluctance to disclose information in the public sector accountability arrangements Greiling and Spraul (2010) notes that, principal-agent and stewardship theories has little to offer for the case of public services.

The objective of Laughlin's critique of Accounting and Accountability Systems (AAS) is to move accounting and accounting research beyond the traditional functionalist's instrumentally rational view.Rather than assuming the automatic superiority of certain approaches and solutions Hopwood (2009) posit that there would be areas where careful analyses of alternative approaches would need to guide action. Critical and social reporting will aid the discharge of organisation's accountability and increase its environmental stability (Gray, 1992).

According to Lehman (2010) and Hopwood (2009) the mainstream accounting perpetuated the narrow focus on the wealth accumulation of owners, no account was taken of growing social discontent of environmentalists, women, minorities, consumers, employees, and other constituencies. Although such concerns were intimately connected to corporate accountability, mainstream accounting consistently failed to expand their horizons to accommodate such concerns, limiting themselves to the narrow preoccupation. Critical accountants, oppose the instrumental rationality of mainstream accounting in favor of new, enabling forms of accounting. They are interested in developing theory and fostering practices that assist in enabling the transformation of accounting and the wider socio-political context towards a more socially just society (Brown & Dillard, 2013).

According to Tilling and Tilt (2003), critical accounting theory has a two- fold aspect, in keeping with general critical theory in its application to accounting. The first, a contextualisation of the practice of accounting within a wider domain society, history, organisations (Lodh & Gaffikin, 1997), "While it is acknowledged that a great deal is known about the technical aspects of accounting, it is argued that little is understood about either accounting's social roots or the interconnection and interrelationship between the social and the technical" (Laughlin, 1987, p. 479). Part of this contextualisation is the recognition that accounting is not a science, but a human endeavour. Puxty et al. (1987) emphasises that the provision of accounting information is a political process, and merely a technical matter; it is therefore necessary to recognise the role of human actors in the process of regulation and preparation of financial report and the struggles between various interests and actors within a certain socio-political context.

The second aspect of Critical Accounting Theory is a call to action, to participate in an actual transformation of 'the system'. It is the view that the present is not

satisfactory, that reality could be better than it is (Laughlin, 1987, p.482).

Brown and Dillard (2013) strongly object to the narrow technocratic way the accounting profession currently approaches the normative purpose of accounting, especially the taken for granted assumption that it should steer decision-making and accountability in line with the dictates of neoclassical economics.They also posit that mainstream accounting's lack of a critical dimension, leading it to deny, ignore or downplay the injurious effects of power relations in organizational and social settings especially in the current neoliberal context. The authors seek new critical accountings that are relevant to policy and practice and see democratic political theory as key in helping:

- to understand accounting in its wider socio-political context;
- to evaluate existing accounting policy and practice (e.g. in terms of how it approaches accountability issues, governance and the management of resources); and
- to offer ways of working towards more enabling accountings.

2.5 Dogma of Critical Accounting Theory

O'Regan (2003, p.7) identified two main branches of Critical Accounting dogma. The first group in the movement seek self-justification in the reductivism of modernist dogmas such as Marxism, Maoism, environmentalism, or thirdworldism. A second group comprises those who reject such grand narratives, and seek to push the boundaries of their radical critique into the cultural milieu characterised by "events that are transitory, selves that are fragmented, ideas that are constantly changing, all without any underlying universal laws or guidelines" (Montagna, 1997, p.125). The radical cries of both wings of the movement sound remarkably similar in their opposition to the free market and to traditional social structures.The author concludes that despite the criticism of mainstream accountants against critical accounting, the Critical Accountants have pressed for valuable reform in both behaviour and institutions. It has helped to encourage practical reforms in areas like the structures of corporate governance, the reliability of financial data, and the accountability of institutions. The movement has also changed the tone and terms of debate in the key area of external auditing.

Levine and Smith (2009) in their paper, Critical Accounting Policy (CAP) investigates firms' motives for critical accounting policy (CAP) disclosure and the extent to which CAP disclosures provide information to investors. They posit that CAP section of management's discussion and analysis should include disclosure of those estimates that require assumptions about matters that are highly uncertain, and for which different estimates would have a material impact on the presentation of financial condition. They are of the opinion that CAP disclosures provide new information to investors and investors would be in a better position to assess the quality of, and potential variability of, a company's earnings. CAP disclosures also reduce firm's exposure to lawsuits. The authors demonstrate that the CAP section, which includes a selection of which policies qualify as critical and their description, is informative and that investors appear to incorporate the information into valuations.

Levine and Smith (2009) define a CAP as a policy in which both of the following are true:

- the accounting estimate requires assumptions about matters that were highly uncertain at the time the accounting estimate was made and
- different estimates that reasonably could have been used or changes in those estimates that are likely to occur from period to period would have a material impact on the presentation of financial condition or results of operations. The disclosure would involve three elements: the information needed for a basic understanding of the estimates, information needed for an understanding of the sensitivity of the results to the estimates, and a discussion of whether management and the audit committee discussed the development, selection, and disclosure of the critical estimates. The rule was criticized for being too broad, for requiring information that would not be useful to investors, and for excessiveness to the point of obscuring rather than revealing.

CONCLUSION

A critical accounting policy is one that is both very important to the portrayal of the company's financial condition and results, and requires management's most difficult, subjective or complex judgments. The circumstances that make these judgments difficult, subjective and/or complex have to do with the need to make estimates about the effect of matters that are inherently uncertain. As the number of variables and assumptions increase, those judgments become even more subjective and complex. As the time period increases over which the uncertainties will be resolved, estimates will likely change in a greater number of periods, potentially adding volatility to published results (Levine & Smith, 2009).

Accounting is one such colonising force which must be tamed within the parameters of communicative reason. To reach true understanding in a life-world requires a cultural tradition that ranges across the whole spectrum of human knowledge, not just the fruits of science and technology as instrumentally conceived. Accounting, in neglecting the totality, in favour of a conceptual framework approach severs its links with the life-world (Lehman, 2010).

Even more pressing for modern society is the need to consider how accounting has been influenced by this cultural trend that has slowly been transforming itself to the dictates of technology, rather than technology transforming itself to the dictates of culture.Accounting

and business research has blindly follow trends that end up entrenching a culture of bureaucratic and instrumental control (Lehman, 2006, 2010). The end product, invariably, is a failure to create a critical and meaningful discourse. In the process, bureaucratic and technical trends further damage and narrow the prospects for the attainment of freedom.

The above sections discussed the theories of accountability and from the discussion; it is evident that the development of theories over the decades play an important role in the development of financial accountability framework for public sector.

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