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On foxes becoming gamekeepers: the capture of professional regulation by the Australian accounting profession

Abstract

There are such persons as liars, damned liars and experts, and there are accountants, bad accountants, and worse accountants. (Debate on the introduction of the Public Accountants Registration Act, New South Wales Parliament, 1944, p. 856) Both the state and the professions have an important interest in safeguarding the quality of service and the protection of the public with respect to the provision of professional services. In the main, the states focus on professional performance and accountability, and the professions emphasise the maintenance of quality and improvement in the skills of members. With respect to the accounting profession the state has taken two basic approaches to improving professional performance and accountability. The first approach, through imposed competencies embedded in various state registration Acts, regulates a minimum level of performance. The second approach addresses the issue of accountability through the imposition of specific standards of conduct, sanctions and reporting requirements ...

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On Foxes Becoming Gamekeepers: The Capture of Professional Regulation by the Australian Accounting Profession

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There are such persons as liars, damned liars and experts, and there are accountants, bad accountants, and worse accountants. (Debate on the introduction of the Public Accountants Registration Act, New South Wales Parliament, 1944, p. 856)

Both the state and the professions have an important interest in safeguarding the quality of service and the protection of the public with respect to the provision of professional services. In the main, the states focus on professional performance and accountability, and the professions emphasise the maintenance of quality and improvement in the skills of members.

With respect to the accounting profession the state has taken two basic approaches to improving professional performance and accountability. The first approach, through imposed competencies embedded in various state registration Acts, regulates a minimum level of performance. The second approach addresses the issue of accountability through the imposition of specific standards of conduct, sanctions and reporting requirements. A recent example of this approach is the decision, in April 2004 by the Singapore government to introduce the Accounting and Corporate Regulatory Authority, through the amalgamation of the Register of Companies and Businesses and the Public Accountants Board. This authority is responsible for administering the *Accounting and Corporate Regulatory Act (2004)* and represents a proactive move by government away from professional self-regulation following the many accounting scandals of recent times, such as Enron and WorldCom. However, the perceived need for government regulation is not new. State regulating authorities exist in most (if not all) the states in the United States (for example, the Accountants Board of Ohio, Nevada State Board of Accountancy, the Board of Public Accountancy in Massachusetts), and central regulating authorities also exist, for example in the Republic of South Africa (the Public Accountants, and Auditors Board). In countries where a regulating authority does not exist (for example, in the

United Kingdom, New Zealand and Australia) the professional accounting bodies have been lobbying (to date without success) for regulation.

To protect the public the professions require members to undertake continuing professional development programs, and impose a system of certification on members engaged in public practice. These programs generally require skills be demonstrated at levels higher than the competency requirements necessary for registration. Most professional bodies also enforce strict self-regulation requirements to discipline delinquent members. Thus one might expect that in Australia an 'accountant' is a person of integrity, professional competence and has adequate indemnity cover. Unfortunately this is not the case, because currently there is no legal impediment in Australia preventing any person, of whatever qualifications and experience, from presenting themselves to the public as an accountant. This chapter considers the paradoxical case of the Australian accounting profession in New South Wales, which was once government regulated, but lobbied successfully to remove this regulation and more recently attempted, without success, to reinstate it. The chapter focuses on this regulatory vacuum and the impact, in terms of protection of, and redresses by, the general public, whose accounting requirements are undertaken by accountants in public practice.

Theoretical Background

Three general theories explain regulation that limits professional licensing of accountants: capture theory, public interest theory and, at a general level, political economy theory. While these theories are well known in the professional regulation literature, a brief overview is provided for background.

Capture theory, in its simplest form is a straightforward application of self-interest. Accounting professionals 'capture' the regulations, or the regulator, governing licensing and structure them to limit the supply of accountants and thereby increase their incomes.

Public interest theory, by contrast, suggests that professional licensing occurs due to some market 'failure', and that its intent is to increase the welfare to society. Public interest theory presumes that, due to the complex nature of the service and uncertainty

about the efficacy of competent service, consumers of professional services lack complete information about the quality of such services. Public interest theory asserts that the professional licensing corrects this market deficiency by ensuring that accounting professionals are of a sufficiently high and standard quality.

Political economy theory, in contrast to both capture theory and public interest theory, entertains the possibility that both the public and accounting professionals affect the existence and form of accounting professional licensing regulations. Political economy theory is basically a theory of checks and balances.

Government Regulation and General Public Protection

This study asks why the accounting profession in Australia is the only group of professionals offering services to the public which is not regulated by either state or Commonwealth legislation.

The *Public Accountants Registration Act 1945* received assent in the New South Wales (NSW) Parliament on 5 April 1945. It had two major purposes: to provide for the audit of certain accounts by registered public accountants, and to regulate the qualifications for registration as a registered public accountant. Under the Act, a 'public accountant' was defined as:

an accountant who maintains an office *as a principal either alone or with others for the business of General Accountancy* and the auditing of accounts and in that office *places his services in any such regard at the disposal of the public generally for remuneration* and whose services are not either entirely or mainly at the disposal of any individual firm, trust or association. (*Public Accountants Registration Act 1945*, p. 107) [emphasis added]

The Act was quite clear that its purpose included protecting the public interest, specifically the offering of accounting services to the general public, in addition to the wider arena of auditing.

To achieve this protection, the Act clearly set out the qualifications necessary for registration, which included: being over 21 years of age, being of good fame and character, having passed prescribed examinations and acquired practical experience in

accountancy, or be the holder of a certificate of membership issued by an approved institute of accountants, or having passed the final examinations of any approved institute of accountants. To ensure compliance with the requirements and the spirit of the Act, specific disciplinary provisions were included. These required that a complaint or charge against any registered public accountant of infamous misconduct as a public accountant be referred to the Public Accountants Registration Board for investigation. The board was empowered to conduct any inquiry, investigation or hearing, and hold any such inquiry, investigation or hearing in open court. Where the public accountant was judged guilty, the board could choose to reprimand or caution him, suspend his registration, or direct that his name be removed from the register (*Public Accountants Registration Act 1945*, pp. 117–118).

So intent was the Act on protecting the specialist title of ‘public accountant’ and the public interest and enforcing the educational and practical requirements of registration, that it prescribed penalties for persons posing as a registered public accountant without registration:

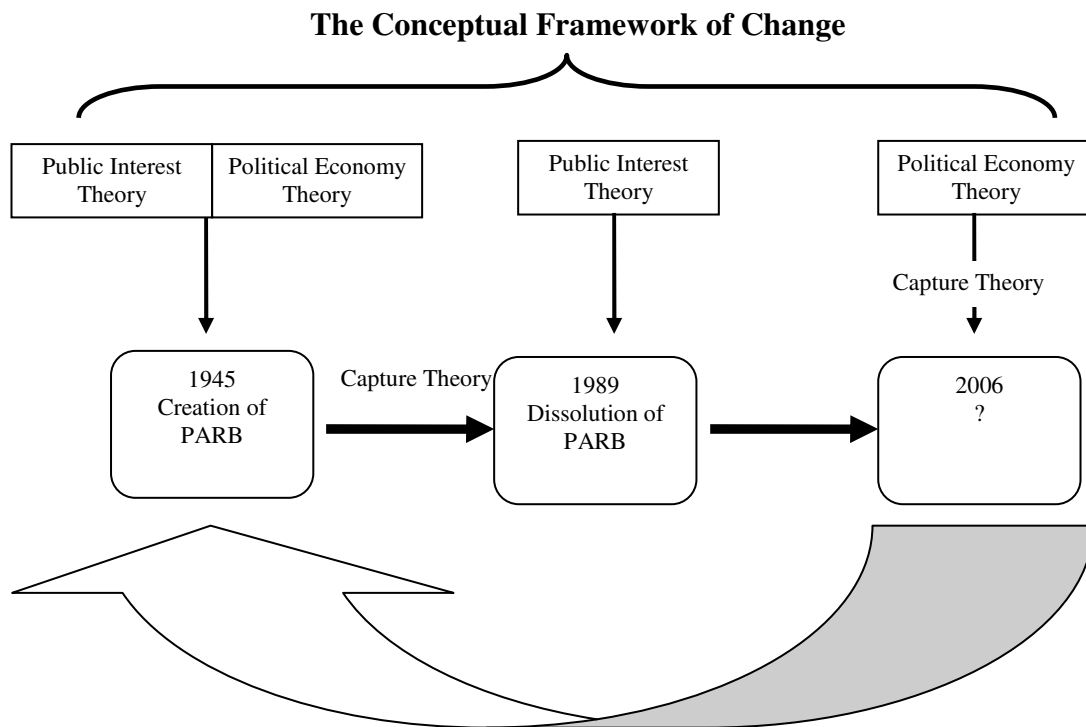
... either alone or having regard to the circumstances in which it is taken or used indicates or is capable of being understood to indicate or is calculated to lead persons to infer that he is a registered public accountant *shall be guilty of an offence* (*Public Accountants Registration Act 1945*, p. 120). [emphasis added]

This provision meant that only accountants registered under the Act could undertake accounting work on behalf of the general public, and the specialist title was protected by legislation.

Creation of the Public Accountants Registration (PAR) Act

Three theories underpin the conceptual framework used in this chapter to examine the creation and implementation (in 1945) and dissolution (in 1989) of the PAR Act: public interest theory, political economy theory, and capture theory. The conceptual framework of this change is depicted in Figure 1.

Figure 1



The desire of the NSW government to regulate is supported by Mitnick's (1980, p. 20) definition of regulation as 'the intentional restriction of a subject's choice of activity, by an entity not directly party to or involved in that activity'. Merino and Mayer (2001) provide a more theoretical description of regulation as that which results in the redistribution of economic resources among various competing interest groups through the use of state power.

The key objective of the theories of economic regulation is to explain who will be positively, and who negatively, impacted by the regulation (Stigler, 1971). Roberts and Kurtenbach (1998) contend that the public interest theory, political economy theory, and capture theory of regulation explain state intervention in the economy. Roberts and Kurtenbach (1998) provide the example of the *Model Accountancy Act* developed by the American Institute of Certified Public Accountants in 1981. They argue that regulation of the public accounting profession is desirable because the public makes critical decisions based on the financial statements examined by public accountants, the public relies on their competence, and the public cannot be reasonably expected to investigate the underlying qualifications of each accountant.

Public Interest Theory

Public interest theory proposes that regulation maintains and protects the public. Regulation of industry and organisations protects and benefits all of society (Deegan, 2005; Stigler, 1971). The public needs protection through regulation because when economic markets are left alone they are unlikely to operate efficiently (Posner, 1974). While Roberts and Kurtenbach (1998, p. 211) conclude that the ‘existence of a market imperfection is sufficient rationale for government intervention’. The debate and discussion in 1944 and 1945 reveals that the NSW Government believed that the PAR Act was based primarily on the protection of the public. For example, the Assistant Minister who introduced the Bill, Mr Evatt, declared ‘(T)he chief merit of the measure is that the public will be protected’ (NSW Parliament, 1944, p. 855). His view was supported, but described somewhat disrespectfully by Mr Sheahan MLA, as ‘a bill for the purpose of protecting the public against quackery and dishonesty in accountancy’ (NSW Parliament, 1944, p. 858)

This theme is repeated throughout the various readings and debates: however, over time, other ‘reasons’ for the Bill were also put forward. For example, ‘the first consideration is the protection of the public and the second is the protection of the practitioner or the would-be practitioner’ (NSW Parliament, 1944, p. 857), a view first introduced by Mr Williams MLA, who also happened to be an accountant. Later in the debate Mr Evatt explained that ‘the Government desires to place a measure on the statute book, not only to protect the public, which is its primary purpose, but also to give to the accountancy profession the prestige and importance that it now lacks’ (NSW Parliament, 1945, p. 1764)

Political Economy Theory

Political economy theory postulates that economic regulation protects the private interests of politically effective groups, in this instance, the professional accounting bodies (Deegan, 2005; Posner, 1974). This theory explains the majority of the debate and discussion that the Opposition used during the introduction, and up to the adoption of the Bill. For example Lieutenant-Colonel Bruxner of the Country Party argued that ‘the profession itself should have majority representation on the [PAR] board’ (NSW Parliament, 1945, p. 1756). This view was supported by his colleague Mr Brain, who suggested ‘most emphatically that the accountancy profession, which

has done an excellent job over the years, should have a preponderance of representation on the board' (NSW Parliament, 1945, p. 1806).

One of the main roles of the Public Accountants Registration Board (PARB) was to set the standard of qualifications necessary for registration as a Public Accountant. Mr Brain and Lieutenant-Colonel Bruxner, among others, constantly argued that the majority of members on the board should come from the profession. Their position is consistent with Stigler's (1971) assertion that every occupation that has the enough political strength will seek to control the regulator.

Capture Theory

This theory contends that regulated parties will capture the regulatory mechanism, in this case the accounting profession and the PARB (Mitnick, 1980). Both Mr Brain and Lieutenant-Colonel Bruxner argue that such an event 'capture' is preferable. This confirms Deegan's (2005, p. 115) view that 'regulated parties seek to take charge of (capture) the regulator so that the rules that are subsequently released (post-capture) will be advantageous to the parties subject to the requirements of the rules'. The Opposition's discussion is an example of the theory defined by Laffont and Tirole (1991, p. 1089) whereby regulation 'is acquired by the industry and is designed and operated primarily for its benefit'.

Mitnick (1980) identifies two events which show that an organisation has 'captured' its regulatory mechanisms. The capture events relevant to the PARB are where the regulated organisation, the accountancy profession, has control over the regulation and the regulatory body. The second relevant event is where the activities of the organisations coordinate the regulatory body's activities. The debate and discussion of the Bill shows that the accounting profession had the potential to capture the regulator in due course. Even though the Opposition amendment to change the structure of the board (from two to three members from the profession) failed, two of the remaining three members were the Auditor General and the Under Secretary of the Treasury, both generally trained and qualified accountants. The only possible non-accountant on the PARB would have been the chairman. Even though the Bill had passed with only two members of the PARB to be from the profession, the Board would likely have contained predominantly accountants. Regulatory capture was probably expected in

the drafting and development of the Bill. This conclusion dovetails with Walker's (1987, p. 281) finding that 'the general literature on "regulation" is replete with allusions to the tendency for regulatory agencies to be "captured" by the interest groups and thereafter to operate in the interest of those elements of the community that the agencies were established to regulate'.

The Removal of General Public Protection

From 1945 to 1989 the general public of New South Wales was protected by the provisions of the *Public Accountants Registration Act*, and through this had a mechanism that ensured an acceptable level of competency. While the profession did capture the regulatory body, the regulator could still protect the public interest. It also provided some reassurance that every accountant offering an accounting service to the public was so registered, and that this registration (and therefore the ability to practice) could be removed for infamous misconduct. However, from 1989 onwards, this protection of the general public was removed with the adoption of the *Public Accountants Registration (Repeal and Amendment) Act, 1989*.

Deficiency was well known in the accounting profession, as evidenced by a statement made by a senior advisor of the Institute of Chartered Accountants in Australia when addressing the Joint Committee on Corporations and Securities in 2001. In response to a question on licensing from a member of the Committee, the ICAA representative responded:

Senator Cooney, *you could be, and call yourself, an accountant if you wanted to*. If you were going to charge to prepare a tax return you would have to be licensed and registered. If you wanted to audit companies you would have to be registered, but *if you wanted to provide very sophisticated financial advice, very sophisticated taxation advice, there is no licensing requirement*. (Commonwealth of Australia Parliamentary Papers, 2001, p. ??) [emphasis added]

The purpose of the repeal Act, it was claimed, was to remove the parallel system of registration of auditors in New South Wales, specifically, the registration of company auditors under the then *Companies Act* and registration under the *Public Accountants Registration Act*. It was stated in the parliamentary debate that the dual system was

‘an unnecessary burden and a costly duplication of effort’ (NSW Parliament, 1989a, p. 6318). It was also argued that the need to obtain registration in New South Wales as a registered public accountant stemmed solely from the requirements of various state Acts, which required audits to be carried out by a registered public accountant. Further, the then Minister for Business and Consumer Affairs, claimed that the repeal legislation was consistent with the government’s policy of removing unnecessary regulation and duplication where it was in the public interest to do so. This completely overlooked that the public interest extended to the general public and was not limited to public companies, large private companies or statutory authorities. The parliamentary debate also referred to the fact that both the professional bodies associated with accounting (the then Australian Society of Accountants and the Institute of Chartered Accountants in Australia) supported the repeal Bill. For example, Mr Dowd NSW Attorney General stated ‘the proposal to repeal the Act is supported by the Australian Society of Accountants, the Institute of Chartered Accountants and the Public Accountants Registration Board’ (NSW Parliament, 1989c, p. 5785). While the exact reason for this is not clear from the debate, the professional accounting bodies may have considered that this step would enhance their professional standing through increased professional self-regulation.

At the time of the repeal of the *Public Accountants Registration Act*, changes were also being made to the *Corporate Affairs Commission (Auditors and Liquidators) Amendment Act*, which became the sole registration required for company auditors in New South Wales. During the discussion of the repeal of the *Public Accountants Registration Act* and the establishment of the Companies Auditors and Liquidators Board (CALDB), it was recorded in Hansard that ‘under the Bill, the Institute of Chartered Accountants and the Society of Accountants will supervise such registration and virtually set the requirements for registration’ (NSW Parliament, 1989b, p. 6322). This was never the case however, and registration with the CALDB is controlled under Section 128 of the Corporations Law. Membership of a professional accounting body was not a prerequisite (P. Oakes, personal communication, 23 November 1994).

While the professional accounting bodies may have been misled, their action in supporting the repeal legislation is consistent with professional organisations’ striving

for the attainment of self-regulation and claims to autonomy, together with the balancing of private and public interest (Gyarmati, 1975; Macdonald, 1985; Parker, 1994).

The Reality of Nonregulation

The following cases are representative of the problems facing the accounting profession and the general public when unqualified persons, in terms of the former public accountant registration requirements, are allowed to provide accounting services to the general public or are allowed to continue in public practice following blatant exhibitions of improper conduct and complete disregard of acceptable standards of professional behaviour. They are not cases relating to public companies or statutory authorities, which would have been protected by the CALDB, but represent issues relating to the general public.

The first case concerns a member of the then Australian Society of Certified Practising Accountants (ASCPA) who had been registered under the Public Accountants Registration Act and held a practising certificate from the ASCPA. This member was found guilty of fraud involving \$1,500,000 relating to the unauthorised use of clients' monies and improper investments. Despite his conviction and forfeiture of his society membership he still continued to act as an accountant in public practice. The second case involved an ASCPA member, a young woman who, after graduating from university and obtaining associate status with the ASCPA, established an accounting practice and defrauded the Commonwealth Government of an estimated \$800,000. She was sentenced to six years' imprisonment and also forfeited her society membership. In a third case, a society member who held himself out to be in public practice, without the experience and public practice certificate required by the ASCPA, was found guilty of obtaining a financial advantage by deception when he misappropriated a client company's cheque directly into his personal bank account.

In the first case nothing stops the former accountant from starting in business again. This compares to the prohibition that would have been placed on him under the Public Accountants Registration Act, specifically the requirement to be of good fame and character. In the other two cases, under the old legislation neither of the former accountants would have been allowed to commence business because they did not

have the experience required under the Act. While legislation would not necessarily have prevented these occurrences (particularly the first case), the old legislation would have prevented the accountant in the first case from returning to public practice, and would have made it difficult for the accountants in the other two cases from commencing public practice.

It is questionable whether the disciplinary action, which can be initiated against a member by their particular professional organisation, offers any protection to the public. Greater protection would be gained by an attempt to prevent the problems outlined above from occurring, rather than exact ineffective disciplinary action after the event. Such protection was provided to the public through the *Public Accountants Registration Act*, specifically in the minimum experience requirements and the prohibition that, once disqualified, it was no longer possible to provide accounting services to the general public.

Conclusion

The chapter argues that the establishment and the repeal of the *Public Accountants Registration Act* was an example of regulatory capture theory and demonstrated by Mitnick's (1980) identifiable events. It also provides empirical data to support the argument that the removal of the universal protection left a gap in the protection provided to the general public. The repeal of the *Public Accountants Registration Act*, with the focus on company auditors, completely overlooked the impact this would have on the general public, who were left without any legislative protection from those offering their accounting services and not members of the professional bodies. It also created a loophole which allowed unqualified and professionally disbarred individuals to operate with apparent impunity.

Taken together, these events to purportedly achieve government efficiency and competition have debased the image of accounting in the minds of the general public and possibly destroyed years of professional upgrading by the professional accounting bodies.

While governments are unlikely to protect the generic title 'accountant', restriction of the title 'public accountant' previously afforded the general public the protection, to

some extent, they expect from their elected representatives. Such a direction would be consistent with the legal profession, where the generic title 'lawyer' indicates a person who has graduated in law, while 'solicitor' and/or 'barrister' are protected titles. Similarly the term 'doctor' is a generic description with public protection given to the protected title 'registered medical practitioner'.

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