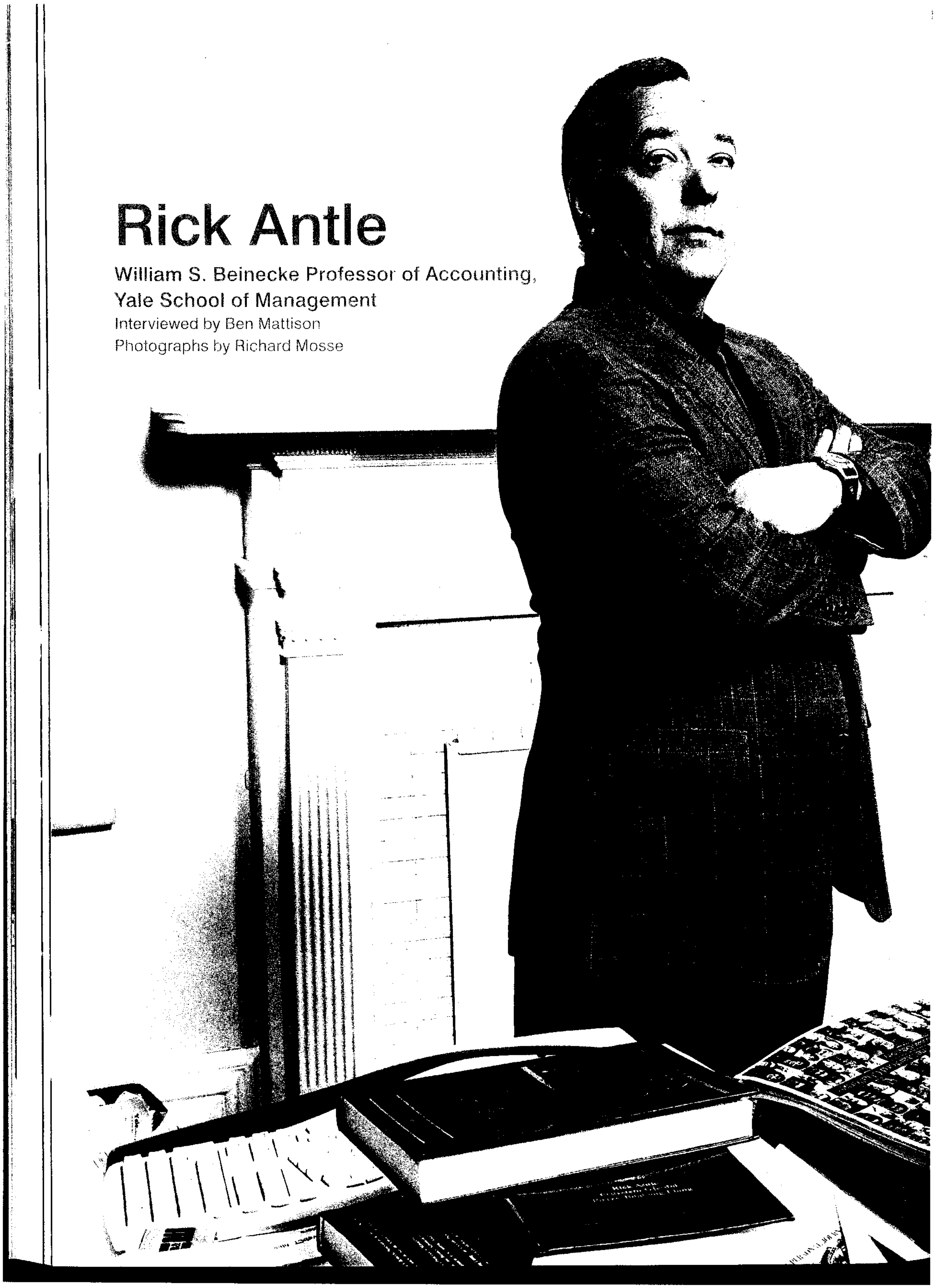
Rick Antle

William S. Beinecke Professor of Accounting, Yale School of Management

Interviewed by Ben Mattison
Photographs by Richard Mosse



What happened to the accounting profession?

For most of the twentieth century, accountants were organized into a self-governing profession, but that structure has been shaken over the last decade by a wave of scandals. Yale SOM professors Rick Antle and Shyam Sunder discuss the implications for management of accounting's successes and failures as a profession.

Q: In thinking about professionalizing management, perhaps we should ask, does the professional model work for accounting?

Rick Antle: If we say, "In the twentieth century, how did the professionalization of accounting work out?" I would say it worked out very well. After the passage of the Securities and Exchange Acts of 1933 and '34, financial markets grew and got much more structured and organized, and I think a large part of that was the reliability of audited financial data. A profession of accounting was built, and financial accounting standards and auditing standards were set.

I think the CPA exam did serve as a quantity barrier, but I am unsure of its role in affecting quality. Letting accountants make a little extra money along the way in the '40s and the '50s and '60s was a way to attract a talented pool of people that might not otherwise have thought, "Gee, I'll be an accountant."

So I think it worked very well to accomplish what society thought it wanted, which was having the capacity to generate pretty darn reliable financial information for publicly traded companies.

Shyam Sunder: May I add that in the last few decades we may have gone a bit too far in pursuit of standards. All professionalization is accompanied by some standards. Pressed by their legal liability, accountants created organizations whose sole function is to write standards. Once such organizations have been created, their existence encourages demand for endless clarification of rules. Whenever accountants get sued, or are under pressure from management, it is easier for them to go to the rule-making organizations and say, "The rules are not clear. They do not tell me what is appropriate in this case." Rules can never substitute for all professional judgment.

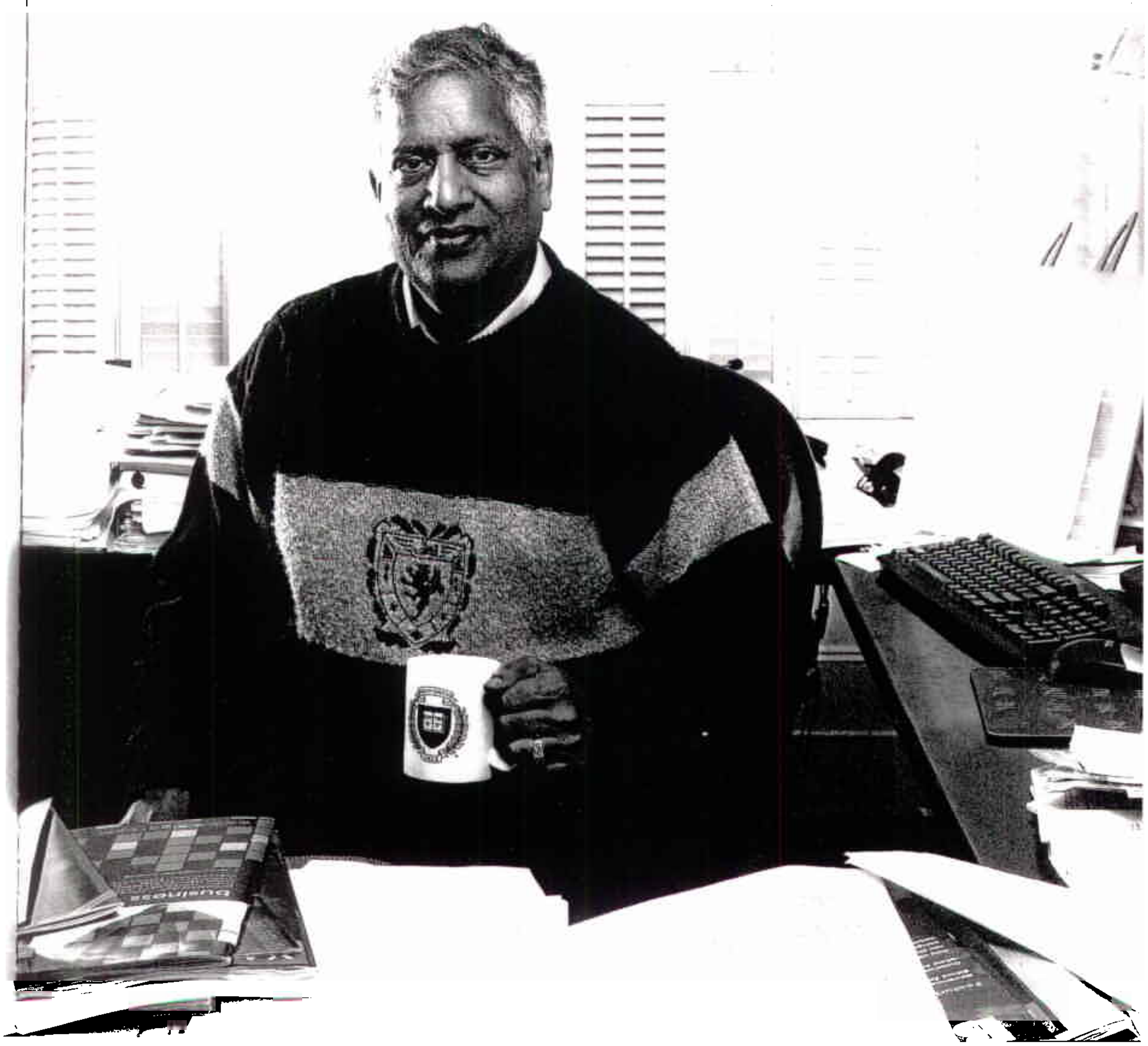
The present institutional structure for writing accounting rules was intended as a solution to the accountants' problem of minimizing conflict with their own paymaster-clients and minimizing their liability. In the big picture, this shift in emphasis from judgment to rules has damaged their professionalism. No profession can rely on rules as the main basis for its work. If their expertise lies in doing a fast search through the rulebook to find the rule applicable in a given situation, it is worth remembering that search engines are largely free—such experts should not expect to be paid much.

RA: What Shyam and I are both saying is that organizing as a profession has its advantages, but it's not a panacea. In particular, the advantages for accounting were in part because it was a narrow task, relative to management, that society wanted to accomplish: the provision of more reliable public financial data.

But then as time goes on, besides just laying down the basics, you get more and more under the hood, into exactly what you have to do. And then you add liability on top of it. Once you have a profession, you have guidelines you're supposed to follow; of course, you can then get sued by people who claim that you didn't follow the rules. Then if the defense, as Shyam has accurately said, is "the rules weren't clear," then you start making more precise rules. To me that's just

Shyam Sunder

James L. Frank Professor of Accounting, Economics, and Finance, Yale School of Management; President, American Accounting Association



exactly the opposite of what you want people who are leading actual business organizations to do.

> SS: Sooner or later, you're not a professional anymore, because you're just looking at the rulebook.

Q: Does the accounting profession's experience, particularly its recent experience, provide an encouraging example for trying to professionalize management?

RA: I think that accounting is a good example to look at, and one that in the end is not too encouraging. In recent years, accounting has run into serious problems, which have eroded the notion of professionalism as its organizing principle in favor of regulation and litigation. When the scale of accounting firms got so large, it was very hard for any other affiliation, like an affiliation with the accounting profession, to overshadow the day-to-day world in an accounting firm.

There have been big governance changes after the passage of the Sarbanes-Oxley Act and the institution of the Public Company Accounting Oversight Board. Now what we have is basically quasi-governmental oversight through the PCAOB. It's a governmental not-for-profit organization, but it's pretty clear who's pulling the strings there.

We haven't had a lot of experience in understanding how that's going to work, how disciplinary proceedings and so forth are going to work with that body. Some of these things take decades to play out because, again, litigation is involved.

With Enron, for example, the criminal level was completed not long ago, and now there's a whole bunch of civil litigation. It's going to be ongoing for a long time—five, ten more years. To me it's unclear how that's all going to shake down.

> SS: A great many of the powers and functions of the American Institute of Certified Public Accountants—the professional association—have been taken away, especially when the PCAOB was created four years ago. Accounting is still a profession, but as Rick also suggests, it is a new game for the CPA segment of the profession.
>
> Ultimately things will work themselves out. We do not yet know all the consequences—who will gain and who will lose under the new regime.

RA: I think the first thing you have to get straight when you're talking about professionalization of management is whether you're talking about professionalization in the colloquial sense of acting more professional or in the more narrow, rigid sense of having all of the trappings of the formal professions like law, medicine, and accounting.

If we're talking about professionalizing management in the more colloquial sense, well, it's hard to argue about that. Our colloquial understanding of a professional is someone who has a knowledge base, who can bring expertise, who has an ethical standard whether formally imposed on them or not, and who takes their responsibility seriously. A lot of times when people say, "I'm a professional," really what they mean is, "I take my job very seriously. It's not nine to five. I view myself as selling expertise and services, not just my time. I don't sit at a desk and clock in and clock out. I have to produce things."

All that is fine, but when we cross over to saying management should be, in a more narrow sense, a profession that has all these other trappings to it, I become much more skeptical, and partly it's because of the experience of accounting.

With a profession in the narrow sense, there's a governmental interest in restricted entry—not letting everyone hold themselves out as a Certified Public Accountant when they don't have the expertise to audit a public company, let's say, or not letting someone hold themselves out as an MD who doesn't actually have the training, just because they stayed in the Holiday Inn Express last night. You know there's that commercial...

SS: I haven't seen that.

RA: A guy's in an operating room and he's looking around and he says, "Why don't you do this and that." "Oh, are you the surgeon?" He says, "No, but I stayed in the Holiday Inn Express last night."

The element of restricted entry is really crucial to developing the whole structure of a profession. And when I think of that, I think of something like the CPA exam, which has been a blessing and a curse to people teaching accounting.

It's a blessing in the sense that it motivates students. They know there's going to be an exam and they're going to have to pass it if they want to be an accountant, and so it's not just a matter of getting through school. At the same time, that's kind of a curse, because you get teaching to the exam and you get students who want to be taught to the exam.

On the whole, the exam exerts a narrowing pressure, not a broadening pressure. There's been a constant demand there to just teach the facts and not get too worried about what they mean, because they can't be really asked about that on the exam.

SS: Let's look at the CFOs of corporations, who are typically people with a significant amount of accounting education. A CFO is really more of a business person than a professional. Even though they may have a lot of professional trappings—they may be members of Financial Executives International or the CFO organization, which doesn't have an examination or barrier to entry. To the extent that the CFO responds to the superiors in the organization instead of some other professional calling, these are business positions and not professional positions.

With all that has happened in the recent years at Enron and in backdating of options in hundreds of corporations, it is reasonable to ask, should we have a professional in that position?

What do we mean by that? Should we have somebody in the CFO position who sticks to the rules, who has some obligation and sense of right and wrong about what his or her duties are with respect to some higher principles other than what happens to suit his or her own personal interests or what the CEO orders him or her to do? Would these things have happened if these people were more "professional" in the first sense of the word that Rick mentioned?

If you ask the CEOs in the business roundtable, "Do you want a professional CFO?" I'm not sure how many of them will honestly answer yes.

RA: The key word there is "honestly," right? Because they'll say, "Oh, of course."

SS: But they want a CFO who will—

RA:—make the numbers look like they tell him to make them. I don't necessarily mean committing fraud, but there are judgment calls in accounting all the time, and things you can decide to do one way or the other. A CFO is under a lot of pressure internally to do those things in a way that's more in line with what the CEO I wants to happen.

I'm very skeptical about getting out of that by saying that the CFOs just going to act professionally, that he's kind of an external little doctor in the house. In fact, reasoning again by analogy to the accounting profession, the accounting profession was society's watchdog on financial matters, right? They're members of their own organization, so they're independent; they're not members of the organizations whose financial results they're looking at. Even there, through client pressure and economic incentives and so forth, they too often went along with things or weren't as aggressive as perhaps they should've been. So when I look at the problems encountered by the accounting profession along those lines and hear people say, "Well, we're going solve this by professionalizing people inside the organization," I become very skeptical. I just don't know how that's going to work.

SS: I agree. These corporations did have general counsels who are licensed professionals, and they largely seem to have gone along with options backdating in so many cases.

If we step back a bit, we can see an interesting dynamic here.

In the mid-twentieth century, Milton Friedman and Simon Kuznets developed an economic model of professions instead of the older sociological model. Doctors, lawyers, and accountants came to be viewed as using their codes of ethics as barriers to entry so they could make more money for themselves. By the late 1970s, the U.S. government changed its policy and forced all professions, accounting included, to change provisions of their codes of ethics that had tended to limit competition. This change, common to all professions, had an especially powerful effect on auditing, because the quality of work done by auditors is almost totally opaque to their real clients, the small investor.

So in the 1980s, there were huge changes that happened. This change in government policy shifted auditors from the older sociological model of a professional with privileges and obligations to an economic man—just a businessperson like anybody else who's trying to make a buck.

Once they were forced to change the code of ethics and government and the law began to treat them as if they were like everybody else, well, they started behaving like everybody else.

RA: Well, this is where I would disagree with Shyam. I basically view Friedman as being right about this—they were already behaving as everyone else behaved. I don't think there was any golden time when doctors on the whole or lawyers on the whole were any more or less ethical or moral than they are now. I do think Shyam is right about the fact that society has de-professionalized the professions in some way by treating members of professions more like they treat everybody else, for example, with advertising and competition.

Now, I think the reason that professional-type discipline might've worked before would be that, if you have a body that passes out a certification with which you as a practitioner can earn abnormal economic rent, then the threat of taking that away acts as a discipline to you. You're earning more profits in some sense than you should because of your professional affiliation.

So I think that some of what's happened is about the question, do we want the delivery of these professional services to be efficient in some economic sense? Where does that weigh in? Or is their delivery just not subject to the same kind of efficiency pressure?

SS: Rick, my point was that efficient delivery of services is a quality that is not easy to observe for the customer. It's a very difficult problem. Since the introduction of antitrust laws in the 1890s, government recognized that and gave extra leeway to the professions. It said, "Okay, you can have a little protection from competition and make a little bit of extra money, but remember that the price of making that extra money is that you have a higher responsibility to society."

RA: I agree with that entirely.

SS: And I think in the last 25 years, that social contract was changed. In medicine, it happened with the introduction of Medicare in 1965; for accountants, the 1979 change in their code of ethics was the watershed.

RA: Oh, absolutely. Another factor in the change, I think, is the litigiousness of our society. It's very hard for some organization like the American Institute of CPAs or the American Bar Association or the American Medical Association to take action against a member that is ahead of any litigation that the member might be faced with. Once you start disciplining a group through the courts, then all sorts of things weigh into it—due process and so forth. I'm not disparaging that; I think that's good.

But once there's action in the legal arena, how is a professional regulatory body going to preempt that? The AICPA had a very difficult time with taking actions on members who had even potential litigation hanging over their heads. And due process is a big part of that. Are you going to make some administrative ruling that is then going to be used by the plaintiff to prove guilt, when in that administrative hearing you haven't had all the due process protections that exist in court?

Q: It seems like accounting shows that organizing as a profession doesn't exempt the group from social forces.

RA: That's right. In fact, that's kind of an underlying theme of what we've been saying.

> SS: The auditor is an outsider who goes into a company to tell his paymaster, "You can't do this, you can't do that," when such assertions may cost the latter millions of dollars in compensation. That's a huge amount of pressure. The auditor can seek support in his professional training, and at least an outside CPA has the support of his colleagues in his firm.
>
> In contrast, for an accountant who works for a corporation, his or her job and future depend on the boss. If the boss says, "Do this, do that," what are you going to do? To what extent can you stick to what you think your ethics or your commitment to your profession requires you to do, versus what your boss is asking you to do? Accountants face this conflict as outside auditors and as employees of business organizations.

RA: You were right in saying that because you're a profession you're not exempted from these other social pressures. I think maybe the attempts to professionalize should be thought of as kind of adding another level of pressures, another obligation. And of course, if it makes any sense to add it, it's got to be because it's in conflict with some of the pressures you face from other places, e.g., from society at large or your paymaster.

To have professionalization in a more formal sense matter, it has to be that there are times when there's going to be some conflict of values and you want the conflict resolved by reference to the professional values and not the social pressures or the paymaster's values.

Before you even argue about whether that's been successful in accounting or not, I'd like to point out that professions like accounting and medicine and law that are delivered in the formal professional way are all set up in their own organizations. That is, a public company's independent auditor is not part of the organization that he's auditing—he comes from an accounting firm as an independent party. Same thing with lawyers—there are inside counsel, but just as with accountants that are interna. to organizations, I don't think the record's been that good that when they see some conflict of values that they're going to rely on their profession's codes.

It's hard to see how management could be delivered in some sort of external independent way that allows a practitioner the economic room to say no to a particular client. Or to resign a client. A key part of maintaining your professional status in accounting—or as a lawyer—is to have the right at a certain time to fire your client. Public accounting firms have long been concerned about screening their potential clients and the clients they have—

SS: Even more so now.

RA:—to try to get rid of somebody that is likely to put undue pressure on them, or more than that. If you're a manager, if you're a CEO of a company, you can fire your company, and that's been known to happen, but that's a lot harder to do. And you don't have the independent economic structure to be the outside voice. Managers aren't hired for that. They're hired to be the inside voice.