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Example

AN ASSESSMENT OF THE INSTITUTIONAL FUNCTIONALITY OF ACCOUNTING PRACTICE IN SOUTH AFRICA

by

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ABSTRACT

To date, a comprehensive theory of accounting has not been developed by accounting academics. This absent theoretic basis for the practice of accounting has created uncertainty within the field amongst both academics and practitioners resulting in practitioners having taken over the role of developing accounting standards. As a result, a number of practical problems have arisen within the sector.

In addressing this problem, a body of literature has emerged proposing institutional thinking as a viable basis for the development of an academically sound base for the practice of accounting. This study assesses whether further academic merit can be given to this proposal by establishing whether or not accounting practice does indeed function as an economic institution, specifically within a South African context. Owing to the sophisticated structures that govern the practice of accounting in South Africa, a South African context is considered appropriate for setting international precedence.

In fulfilling the research objective, this study follows a three-step, qualitative approach of an exploratory nature. The first step identifies who the major role-players within the field of accounting in South Africa are and explains what their roles consist of. The second step develops a set of criteria which are generally agreed amongst institutional economists to be present in most functioning macro-economic institutions. The third step then applies these criteria to accounting practice in South Africa to assess whether or not this practice functions as a macro-economic institution.

The outcomes of the study indicate that accounting practice in South Africa does indeed function as an economic institution with strong interdependencies existing between the key role-players thereby granting further academic credibility to exploring the development of accounting theory from an institutional perspective.
KEY WORDS

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CHAPTER 1

INTRODUCTION AND STUDY LAYOUT

1.1 INTRODUCTION

A comprehensive theory of accounting has not to date been developed by accounting academics (Coetsee, 2010: 1). This has led to the development of uncertainty within the field, which in turn has resulted in the creation of numerous problems both in academia and in practice (Inanga & Schneider, 2005: 228). These problems have collectively impaired the effective development of the field with some scholars even contesting that as an academic discipline, accounting has not developed significantly within the last 80 years (Fellingham, 2007: 159).

While there is indeed a wealth of problems that challenge the effective development of the field, a survey of the available literature indicates that there are a few key areas that present particular challenges to the successful advancement of the field. In the sections to follow, these are discussed.

1.1.1 The Academic Status of Accounting

The first of these problems lies in one of the most debated areas within the field of accounting, being the dissent among accounting academics over the academic status of accounting. Despite the fact that accounting has been practised for centuries, accounting academics are yet to reach consensus on what the academic status of the field currently holds (Demski, 2007: 153; Fellingham, 2007: 159; Sterling, 1975: 28). While some consider accounting to be a “full-fledged social science” (Riahi-Belkaoui, 2004: 40) others don’t even consider accounting to be an academic discipline (Demski, 2007: 156). These classification arguments erratically range between these two extremes, with some even viewing accounting to be neither a science nor an academic discipline, but rather an art (Sterling, 1975: 28).

As discussed by Potter (2005: 266), the inability among accounting theorists to reach a credible consensus had in the past, resulted in the research agendas of accounting
theorists being limited largely by the notion that the development of accounting meant the development of its technical practice. Consequently, the field of accounting had only been able to develop within a confined circle of accounting specialists and standard setters. In addition, research within the field had been confined to specialist accounting journals. This led to a present-day phenomenon where the challenges accounting theorists face in developing the field of accounting, are challenges known and appreciated by only a small group of scholars worldwide.

These developments have also resulted in accounting having developed a reputation for being dull and boring (Biondi & Suzuki, 2007: 587; Fowler & Malthus, 2007: 20), which in itself serves as a powerful disincentive for researchers from other fields of study to engage with aspects of accounting practice in a wider economic and social context.

Accounting does not function within a vacuum and is linked with many other fields of study (Suzuki, 1999; Suzuki, 2003). As accounting theorists, many subscribe to the belief that accounting can be developed into a dynamic, multifaceted practice of significant social and economic value (Fellingham, 2007; Gaffikin, 2008). However, it is evident that it is important to understand the relationship accounting holds with other fields of study. Accordingly, without an academically comprehensive theoretical base, no consensus on the academic status of accounting can be reached and without such a consensus, serious research questions cannot be answered. This poses a serious threat to the ability of accounting researchers to develop the field into the academic force it certainly has the potential to become. This has already manifested itself in the South African academic community within the field of accountancy.

According to Inanga and Schneider (2005: 235), at many universities, the output of research in the discipline of accounting is minimal. In South Africa this is no different and in recent years, accounting academics have come under pressure to improve upon their research output in the field of accounting (Van der Schyf, 2008a: 1). Internationally, it is common to find accounting education at the undergraduate level being heavily steeped in the training and practical elements of the discipline, aimed at equipping students for life in practice. At a post-graduate level, the success and
The quality of a university’s accounting department is then often assessed based on the performance of its students in professional examinations (Inanga & Schneider, 2005: 228).

This situation is replicated in South African universities where the academic merit of South African accounting departments (that are accredited by the South African Institute of Chartered Accountants (SAICA)) is primarily assessed based on the performance of their students in Part 1 of the SAICA Qualifying Examination. This reality is also echoed by Van der Schyf (2008a: 2) who, in relation to South African departments of accounting, states that “it is also common knowledge in South African academic accounting circles that the prestige of such academic departments is further enhanced by the performance of their alumni in Part 1 of SAICA’s Qualifying Examination”.

Almost by default, the minds of accounting students are prepared for life in practice, and by implication are severely ill-equipped to deal with the challenges of research and scholarly activity at advanced levels of enquiry. As a result, an important disincentive for accounting academics to engage in research lies simply in the difficult nature of undertaking properly conducted research activity for which they are not suitably prepared. Further compounding this problem is the reality that no academically sound theoretical basis for accountancy exists, making the goal of academic discovery within accounting seemingly more difficult to achieve, even for experienced academics within the field. In a study conducted by Nieuwoudt and Wilcocks (2005: 659) where insights into the attitudes and perceptions of accounting academics at South African (SAICA-accredited) universities towards research were obtained, 89% of respondents stated that the Chartered Accountant (South Africa) (CA (SA)) path that they had followed did not adequately prepare them for research. With regard to the absence of a theoretical base in accounting, and its implications for finding suitable research topics, 61% of respondents conceded that it is not easy to find such topics.

While the problem of accounting research output is indeed a global one (focused more on the quality of the output rather than the quantity), output of research in South Africa is a serious matter of concern (Nieuwoudt & Wilcocks, 2005; Van der
Schyf, 2008a, 2008b; West, 2006), both in terms of quality and quantity. This has been widely acknowledged among South African academics who have accepted that the academic branch of accounting in South Africa has indeed fallen behind much of the world (Nieuwoudt & Wilcocks, 2005; West, 2006: 121). In a recent study conducted by Chan, Chen and Cheng (2007), countries were ranked based on the number of articles they published in 24 of the world’s leading accounting journals. On research volume alone, South Africa disappointingly ranked only at 33. This ranking did not assess the quality of articles published, where it is plausible that South Africa’s ranking could have dropped further if this variable had been accounted for.

As pointed out by West (2006: 122), surveys like these highlight the disproportionate match between the status of South African accounting practice versus that of South African accounting academia. Both within South Africa and internationally, the CA (SA) designation is highly respected and acclaimed (Wadee, 2010: 6; West, 2006: 121). However, on an academic basis, South African Chartered Accountants rank far behind the world’s leaders. For instance, within South African accounting research circles, scholarly activity is largely entrenched in the “teaching and learning” spheres of the profession, with many other research studies being centred on understanding the “perceptions” of participants relating to various aspects of the profession. As part of the background to this research, a survey was conducted on one of South Africa’s leading academic journals, *Meditari Accountancy Research*, to identify the extent to which research addressing fundamental conceptual areas of accounting is published. By analysing the published articles contained within the ten issues published between 2006 and 2010, a total number of 83 articles were analysed. Of these, 43 (52%) articles related to other disciplines including auditing, taxation and financial management. Articles across all disciplines that were centred on “teaching and learning” totalled 16 (19%), while articles centred on performing “surveys” or understanding “perceptions” totalled 10 (12%). Despite this journal primarily being an “accounting” journal, only 14 (17%) articles actually dealt with technical or conceptual accounting issues.

In general, the quality and quantity of accounting research in South Africa simply does not compete with the progressive, multi-disciplinary and innovative research from our overseas counterparts. The danger in this to South African accounting
academics can be expressed through Sterling’s (1973) model which describes the relationship between research, education and practice. As pointed out by Nieuwoudt and Wilcocks (2005: 54), according to Sterling (1973), disciplines other than accounting demonstrate a developmental relationship between research, education and practice as follows:

\[
R(x) \rightarrow E(x) \rightarrow P(x)
\]

Figure 1.1: Sterling’s model on the relationship between research, education and practice in fields of study other than Accounting

The outcome of \( R(x) \), being research drives \( E(x) \), being what is taught (i.e. education) and what is taught (i.e. education) in turn drives \( P(x) \), being practice. Research remains the first and fundamental process to the development of knowledge within a field of study. However, within the practice of accounting, the relationship between research, education and practice operates differently as follows:

\[
P(x) \rightarrow E(x) \rightarrow P(x)
\]

Figure 1.2: Sterling’s model on the relationship between research, education and practice in the field of Accounting

\( P(x) \), being practice, serves as the first and fundamental process to development and hence, drives \( E(x) \), being what is taught (which is governed by SAICA syllabi) and what is taught (i.e. education) is then merely carried out by new entrants into the market in the form of repeated practice \( P(x) \).

In South Africa, the profession has developed largely through the dictates of practitioners and academics who have accordingly directed their academic activities to fulfil the vocational requirements of these practitioners. To date, global academic research has not significantly influenced the development of accounting standards, and by using IFRSs as a basis for accounting education in South Africa, we have
been able to remain relevant players within the field of accounting. However, in the process, South African accountant professionals have become largely disconnected from the discourse surrounding socio-economic dimensions of accounting. By merely participating in the IASB’s standard development processes, many South African accounting academics have developed a misplaced sense of belief that they are actively involved in the development of the field. In essence, academic activity surrounding IFRS application is merely reactive to the dictates passed down by the IASB. By expanding upon the model of Sterling (1973), South Africa’s reactive stance on academic development within accounting, in contrast to the active academic development of the field by its overseas counterparts, can be represented as follows:

The \( P(x) \rightarrow E(x) \rightarrow P(x) \) representation on the right-hand side of the figure indicates the South African reality surrounding accounting research. As it currently stands, South African academics do not lead academic discussions on the socio-economic dimensions of accounting and hence do not play a leading role in directing the profession through research.

In contrast, the \( R(x) \rightarrow E(x) \rightarrow P(x) \) representation on the left-hand side of the figure reflects the state of accounting research in many overseas countries, typically those from traditional western regions. The diagram highlights the notion that should the socio-economic dimensions of accounting theory take on greater levels of importance and influence in shaping accounting practice, South African accountants, both in academia and in practice, face the danger of becoming isolated from the development of their field. This in turn has the ability to significantly impair the global influence on accounting matters which South Africa currently enjoys.
While South African accounting professionals remain to date at the forefront of the profession globally, a potential shift in movement where development occurs through academics and not practitioners will place South Africa in a position of being unable to compete internationally given the poor level of research activity currently undertaken in South Africa. The consequences of not having academic ideas on which to develop an academically comprehensive theoretical base may be detrimental to the development of the profession in South Africa, allowing a further strengthening of the influence that traditional western nations currently hold within the field (Chan et al., 2007: 195).

1.1.2 The Professional Status of Accounting Practice

One of the most conspicuous and fiercely-debated problems associated with the absence of an academic theoretical base in accounting centres on the dissenting views among accounting theorists regarding the social and economic roles that accounting practice plays in modern society; hence the professional status that accounting practice holds.

Despite the fact that accounting practice is afforded professional status in many countries, the legitimacy of accounting’s claim to professionalism has been an area of debate for decades (Gaffikin, 2008; Lotharius, 1962; West, 2003). Central to the issue of professionalism is the consideration of what the role and objective of accounting in society should be.

Accounting is viewed by many to be a disciplined practice focusing on depicting economic phenomena as they occur. As Potter (2005, 270) points out, accounting information is believed by many to be an “objective, faithful representation of the economic phenomena it describes”. The IASB is one such institution that holds this belief. The revised conceptual framework of the IASB contains definitions relating to qualitative characteristics that are required to be present in a set of financial statements before the information contained therein can be considered to be “decision-useful”. One such characteristic is “faithful representation” (International
Accounting Standards Committee Foundation (IASCF), 2010a: A34), explained by the IASB as follows:

Financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only represent relevant phenomena, but it must also faithfully represent the phenomena that it purports to represent.

In addition, the IASB’s revised conceptual framework (IASCF, 2010a: A27), describes the objective of financial reporting as follows:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Accordingly, the need to “faithfully represent” financial information is indicative of the stance that the IASB has adopted in its view on the role and objective of financial information. In summary, they view the role of accounting as being to faithfully capture and depict economic phenomena as they occur and thereafter, to report details pertaining to them to users who have need of such information. In light of views such as these, Gaffikin (2008: 222) states that there are those who subscribe to the belief that accounting is merely meant to “objectively serve the practical interests of business and should not be involved in contributing to broader social goals and policies”. He then goes on to explicitly state that if such a view of accounting holds true, then it quite frankly “flies in the face of claims to professionalism” (Gaffikin, 2008: 222).

In contrast to these beliefs, lies an opposing school of thought that strongly promotes the view that accounting practice “creates” the macro-economic reality we observe through the practice of economics (Suzuki, 1999: 71) rather than it merely being a calculative practice that “depicts” economic reality. This understanding of accounting practice is further echoed in the work of Potter (2005: 267), who points out that it is the language that arises from the practice of accounting (through terms such as
“income, expenses, assets and liabilities” etc.) that goes about creating the economic reality that we “observe” through the practice of economics. In essence, by observing economic phenomena and thereafter reducing their occurrence to understandable, consistent and identifiable concepts, the practice of accounting creates a reality that would otherwise, not have “existed”. Suzuki (2003: 74) further supports this view by stating that through the use of “accounting rhetoric” economic reality is not “depicted”, but instead “created”.

Furthermore, if one analyses the foundations upon which IFRS-generated accounting information is prepared and presented, it is apparent that financial information consists of items to which values are assigned based on principles of “recognition” and “measurement” (with further supporting information often being provided in the form of additional “disclosure”). Accordingly, through the preparation of such financial information, certain economic realities are selectively not included. For instance, a strong management team, pleasant working conditions or positive staff morale are all examples of economic phenomena that exist in reality but are not depicted in accounting information. Hence, it can be concluded that accounting goes about “creating” a reality based on the representation of selected economic phenomena and by so doing, fails to accurately “depict” economic reality.

In summary, the role of accounting in society falls within one of two schools of thought. On the one hand, it is believed to play the role of “depicting” economic reality. By accepting this view as truth, the objective of accounting practice should be a neutral, passive one, merely used to facilitate economic activity through responsive decision-making. On the other hand, some scholars believe that accounting practice instead, “creates” economic reality. By accepting this view, the objective of accounting practice should be to actively regulate the behaviour of economic participants by incentivising them to engage in certain economic practices and abstain from others.

In his book, Gaffikin (2008, 179) states that that dominant characteristic of any profession is its commitment to serving “the public interest”. If one subscribes to the school of thought that portrays accounting practice as a neutral information-provider of pre-existing economic realities, the public interest is certainly not a dominant
concern of accounting practice. However, in moving towards developing a theory of accounting that focuses on the field’s socio-economic dimensions, the uncertainty shrouding its professional status may indeed be lessened.

1.1.3 Developments within Practice

The second problem associated with the absence of a basis of theory discussed earlier, lies in the lead role that practitioners have taken in shaping the direction of practised accounting theory. In the absence of an academically sound theoretical base, practitioners and professional standard setters have taken the lead role in developing not only the practice of accounting, but the academic foundation of this practice as well (Biondi & Suzuki, 2007: 589; Coetsee, 2010: 1;).

As described by Oberholster and Sacho (2008: 117), the period between 2005 and 2006 saw the “largest accounting revolution in recent history” where the accounting standards prescribed by the International Accounting Standards Board (IASB) (namely International Accounting Standards (IASs)\(^1\) and International Financial Reporting Standards (IFRSs)\(^1\)) were adopted by over a hundred countries across the globe. This worldwide movement was largely triggered by new regulations in Europe surrounding the European Commission’s (EC) issue of Regulation 1606/2002 in July 2002, which required all publicly listed firms in European Union (EU) member states to adopt IFRSs for the financial years beginning on or after 1 January 2005. It was during this period that South Africa also adopted the standards of the IASB, subsequently bringing into rule that all domestically listed public companies on the JSE Limited (previously the Johannesburg Securities Exchange) (JSE) must comply with the requirements of the IFRS.

The global reach and authority over the academic foundations of accounting practice obtained by the IASB since the occurrence of these events, resulted in a sudden and abrupt power shift from academics to standard setters, with the development of the profession lying firmly within the hands of the standard setters. In the years that have

\(^1\) IAS standards were issued between 1973 and 2001 by the then International Accounting Standards Committee (IASC). In April 2001 the IASB took over the roles of the IASC, adopted all IAS standards and continued standard development, calling the new standards IFRS standards. The terms “IAS” and “IFRS” are often used in an interchangeable way.
followed, a number of crucial problems associated with this power shift have come to the fore, once again highlighting the problems associated with accounting having no academic basis.

**1.1.3.1 Fair Value Accounting**

One of the major trends currently dominating the development agenda of the IASB takes the form of establishing a set of standards founded on a “fair value” measurement basis (Biondi & Suzuki, 2007: 589). Notwithstanding the influence of the global financial crisis in somewhat restraining the forceful views of the IASB on fair value accounting, the positivity with which the IASB nevertheless seems to be promoting this basis is rather concerning, given the criticism and apparent weaknesses of the model that many published academic articles have brought to the fore.

In their study, Biondi and Suzuki (2007, 590) point out that according to the IASB, the “fair value” model derives its value from providing capital providers with relevant, up-to-date information which serves to facilitate better decision-making. In addition, according to Barth (2007, 11), a “fair value” is considered to be “unbiased, and thus, neutral”. However, Biondi and Suzuki (2007, 591) further point out that fair value measurement promotes a sense of exclusivity by focusing squarely on the supposed information needs of capital providers. Consequently, this brings in to doubt the value of the “fair value model” in providing information to users who are not capital providers.

In examining the IASB’s definition of “fair value”, another problem with this model becomes evident. According to the IASB, “fair value” is defined as “the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction” (IASCF, 2010b: A1110). In his study, Schmidt (2009, 271) points out that the basic premise of the “fair value” model is flawed in two critical ways. Firstly, the model assumes that markets exist for all items that will be valued on this basis, and, secondly, that such markets are active. In reality, this is by no means the case, with the liquidity problems experienced during the recent financial crisis being a suitable case in point (Jaggi, Lee & Winder; 2010: 469).
The above discussion is nevertheless not meant to provide a comprehensive discussion on the weaknesses of the “fair value” valuation model. Instead, the discussion is meant to highlight the manner in which standard setters are known to incorporate new ideologies into their accounting standards without necessarily considering sufficiently the implications and effects of bringing into force new accounting principles.

Accordingly, an academically sound theoretical basis for the practice of accounting is needed to avoid accounting academics delivering such reactive and almost independent criticism to accounting standard amendments and direction changes. By having such a basis in place, standard setters would have to reasonably consider and justify their actions in accordance with a sound basis of theory which will in turn allow accounting academics a basis on which to rationally and impartially consider the credibility of their arguments.

### 1.1.3.2 Convergence of Accounting Standards

Another objective of the IASB currently being pursued is that of establishing a globally converged set of accounting standards (Biondi & Suzuki, 2007: 589). This move to establish a uniform practice of accounting worldwide is another element of the IASB’s behaviour that is fraught with concern.

The most pressing of those concerns are those associated with the challenges that would be involved in reconciling the cultural, political and regulatory practices of countries with the accounting practices required of IFRS (Rezaee, Smith & Szendi; 2010: 144). As pointed out by Oberholster and Sacho (2008, 128), the implications of enforcing a “one-size-fits-all” approach are potentially most damaging to developing economies. In territories where local, generally accepted accounting practice (GAAP) is practised, abruptly enforcing IFRS compliance could for starters, place undue pressure on such economies to modify legislation that may be in conflict with IFRS. In addition, the need to reform their education facilities to accommodate IFRS training (not only for preparers, but for auditors as well) and also to invest significant human capital in establishing and understanding reconciliatory calculations between taxation practices and IFRS practices, are also factors that could place
insurmountable pressure on such economies. Implementing such initiatives to accommodate the practice of IFRS is by no means a cheap exercise, and successfully implementing a system of IFRS into any territory will require significant time and funding.

As Biondi and Suzuki (2007: 592) state, “‘standardisation’ is an *ex post facto* phenomenon”. Having a situation where significant time and costs are expended globally, to implement a system of accounting that later reveals itself to be one that fails to provide quite simply, the right information to the right users in the right way, is wasteful. The results of global convergence could be socially and economically disastrous in light of the time and cost investments territories would need to make in order to achieve IFRS compliance.

Accordingly, embarking on a project of this scale brings with it a multitude of significant and intricately complex implications that require serious and well-structured academic discourse founded on a sound basis of theory. In the absence of such theory, as with the implementation of fair value accounting, a range of reactive discussions and criticisms may arise from academics on the dangers associated with the global convergence of accounting standards. An academically sound basis of theory will have immeasurable benefit in allowing for rational, proactive discussion and analysis between both academics and practitioners, thus facilitating a better understanding of the potential implications of such ambitious projects.

**1.1.3.3 Users of Financial Statements**

The identity and information needs of users of financial statements are other areas of dissent among accounting academics (Côté, Durocher & Fortin, 2007; Inanga & Schneider, 2005; Young, 2005). Accordingly, these arguments also serve to highlight how an absent academically sound basis of theory on these matters has given rise to a number of problems within the field.

For instance, Young (2006: 579) argues that the primary users of accounting information are almost taken for granted by practitioners to be current and potential investors, creditors and other capital providers. Albeit to a lesser extent, other
stakeholders such as employees, government officials and revenue authorities are also assumed to be users of financial information, in an almost “matter-of-fact” sort of way. Contained within the initial Exposure Draft issued by the IASB on their Conceptual Framework Improvements Project, are details pertaining to their views on the objective of financial reporting. Among these lies the belief that “present and potential capital providers” are the “primary user group” of financial statement information (IASCF, 2008: 27). On this premise, a revised conceptual framework is being developed where the IASB terms the preparatory foundation of this development as being from the “entity perspective”, where financial reports are envisioned to “reflect the perspective of the entity, rather than the perspective of the entity’s equity investors” (IASCF, 2008: 15). The rationale behind this perspective lies in the belief that the entity has “substance of its own” (IASCF, 2008: 25), which is distinct from the substance of its owners.

According to this perspective, it is understood that in exchange for the provision of capital to the entity, the capital provider obtains a proportionate “claim” to the entity’s resources and consequently, it is information on these resources and claims that needs to be provided to the grantors of these resources (who incidentally are also the owners of the “claims”) (IASCF, 2008: 26).

The abovementioned point serves to highlight the conspicuous absence of empirical data supporting the IASB’s views on the users of financial statements: who they are, and what their information needs entail. As it currently stands, Young (2006: 591) further points out that properly conducted research into identifying the users of financial information and understanding their information needs has not been conducted by standard setters but instead, the identity and information needs of users are largely assumed. Inanga and Schneider (2005: 239) point out that the result of these assumptions is that reported financial information often ends up in reality not even satisfying the information needs of capital providers. The fact that research into identifying users and their information needs is not properly conducted is also highlighted by Côté et al. (2007: 31), who point out that the extent of such research is limited merely to the so-called “consultative process” which standard setters engage in when developing new standards. This, however, is a severely skewed process, as highlighted in the comment made by Côté et al. (2007: 31) that:
Preparers, as opposed to users, are more likely to participate because they are wealthier, less diversified (drawing income from few sources and being more vulnerable to any adverse economic effects associated with a proposed standard), and their economic interests are more homogeneous.

The abovementioned points are further supported by evidence obtained in a recent study conducted by Herz and Larson (2011) where 55 matters issued by the IASB for comment were analysed in relation to the responses that were received, focusing specifically on the split in responses between academics and practitioners. In summary, it was found that from all the responses received by the IASB only 2.7% of those were from academics. In addition, it was also noted that despite the application of IFRS and IAS being practised in over one hundred countries, responses were greatly dominated by traditional “Western” countries, where the United States, Canada, Australia, New Zealand, the United Kingdom and other European countries contributed to 80% of the responses received.\(^2\)

This highlights another important point. By developing theories that underlie accounting practices through processes that in reality consider only the views of certain interested parties, there is the danger that accounting practices may be developed through the dominant views of these very parties. As pointed out by Barth (2007: 7), academic research is “typically unbiased”. Accordingly, by developing the field through the use of practitioner processes as opposed to objective academic processes, the risk of development directed at achieving the predetermined objectives of controlling interest groups remains present.

1.1.3.4 Decision-usefulness Theory

In taking the lead role in developing the principles that underlie the practice of accounting, the IASB has prescribed a fundamental premise to the use of their standards, being that of “decision-usefulness”. Under this premise, the IASB states that only information that is deemed to be useful to users must be reported. To quote

\(^2\) It is interesting to note that from an African perspective, South Africa was the only country known to have responded to the IASB.
the IASB’s objective of financial reporting (IASCF, 2010a: A27) once again, it is stated that:

_The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit._

As pointed out by Inanga and Schneider (2005: 228), this premise of “decision-usefulness” is treated as an “accounting theorem”, yet remains untested in relation to other established theories, for instance those within the psychological and behavioural sciences. In essence, they state that “decision-usefulness” is not a concept which research has demonstrated to have consistency and predictive value. In the first instance, there is no scientific backing to support what decisions are made by users of financial information, and, in the second, there is no scientific backing to support what types of information users find useful.

The concept of decision-usefulness therefore remains a subjective concept based on assuming firstly, who the users of financial statements are and secondly, what their information needs are. On this assumption, financial statements are prepared with the belief that the information contained therein is useful (Inanga & Schneider, 2005: 228).

Through properly conducted academic research into developing a sound basis of theory for the practice of accounting, the subjectivity and apparent weaknesses in such theories can be identified proactively through empirical testing. Accordingly, through active collaboration between academics and practitioners, the time-consuming process of publishing research in reaction to decisions made by practitioners can be avoided.
1.1.3.5 Concluding Comments

The above discussions bring to light the numerous problems that exist as a result of the absence of a sound academic basis of theory in accounting. From an academic standpoint, the status of accounting among universities has been brought into question as a result, and scholarly activity within the field has remained an area of particular challenge. In the absence of academics having developed a sound theory, practitioners have taken the lead in developing accounting standards on which accounting practice is currently based. This has resulted in a number of challenges for the profession where for instance, debated ideologies such as fair value accounting (Barth, 2007; Biondi & Suzuki, 2007) and decision-usefulness theory (Inanga & Schneider, 2005) have been put into practice. Adding to this are the problems surrounding the assumptions on which these standards are based, for instance those relating to the identity and information needs of users. These problems, together with others have also served to bring the professional status of accounting practice into question.

Section 1.1.3 focused on the negative areas associated with the IASB practices in recent years. It is important to note however, that the IASB initiatives have also resulted in much good for the profession, and accordingly, it is not the intention of this study to denigrate the IASB, but instead to highlight the interdependence between academia and practice and further serve to indicate that practice alone, without significant and thorough contributions from academia, will create problems within the field that are certainly avoidable.

1.2 THE STATED RESEARCH PROBLEM

The discussions thus far have centred on bringing to light the fact that there is no comprehensive theoretical basis for the practice of accounting, from an academic point of view. The problems that this absence of theoretical basis has created for both academics and practitioners were then discussed. These discussions expanded upon the problems associated with the uncertainty surrounding the academic and professional status of accounting; how developments within the practice have steered the profession into greater uncertainty; and how scholarly activity remains a
key challenge to the field. Accordingly, the discussions thus far have served to provide the necessary background and information which describes the research problem being dealt with in this study, which can be stated as follows:

As it currently stands, there is no comprehensive, academically sound theoretical basis from which to develop rules, principles and frameworks for the practice of accounting which in turn, is able to serve the public interest.

1.3 THE STATED RESEARCH QUESTION

The research problem described previously brings to light the fact that there currently exists no academically sound theoretical basis for the practice of accounting. In moving towards solving this problem by developing a basis of theory, it is of importance to consider how theoretical bases from other areas within the social sciences may be useful in developing an academic basis of theory for the practice of accounting. Accordingly, by exploring these bases of theory one is able to shift one’s focus away from the technical aspects of accounting and instead, take greater cognisance of its socio-economic dimensions. Accordingly, one is able to develop a greater understanding of social accounting concepts such as how accounting as a regulatory practice creates certainty in the market, how it influences economic participants to engage in certain behaviours or practices, how it incentivises them to abstain from others and which market participants are affected by accounting information. As a result, an understanding of the socio-economic dimensions of accounting serves to provide a stronger foundation in developing a theory of accounting that is able to serve the public interest.

The value of exploring accounting from a socio-economic dimension is emphasised in a number of international studies (Biondi & Suzuki, 2007; Hopwood, 2000; Potter, 2005), and has become the focal area of research behind many international accounting journals (Journal of Accounting and Economics as well as Accounting, Organisations and Society).

In his book, Gaffikin (2008: 21) discusses particular areas of accounting’s socio-economic context. He describes accounting as functioning within the ambit of a
“socially constructed world” which develops in response to “influences at various times”. What can be derived from these statements is the viewpoint that accounting practice, being deeply connected to social phenomena, is largely governed by the social influences acting upon it at a given point in time. Accordingly, the concept of “influence” is central to its practice. In other studies, this concept of influence is discussed within the context of the behavioural influences accounting creates in the socio-economy. For instance, Hopwood and Miller (1994, 1) state that accounting has the ability to influence “... the type of world we live in, the type of social reality we inhabit, the way in which we understand the choices open to business undertakings and individuals, the way in which we manage and organize activities and processes of diverse types, and the way in which we administer the lives of others and ourselves”. Accordingly, the concepts of influence and behaviour are important elements of accounting practice, and in obtaining a greater understanding of accounting’s socio-economic paradigms, these are important perspectives through which the practice of accounting must be explored.

Many academics have suggested the field of institutional economics to be an area within the social sciences that may be able to facilitate this exploratory process. For instance, Young (1996) states that by applying institutional thinking to the practice of accounting, one is allowed to explore the possibilities of developing creative accounting solutions to accounting problems without being constrained by the traditional approaches of “recognition”, “measurement” and “disclosure”. This view on utilising institutional economic theory in exploratory accounting research is also held by Lanis and McFarling (2004: 81), who state that “...it is possible to use healthy economic theory to help heal “autistic” accounting theory”. These views are also echoed by Potter (2005: 284), who states that through his work he seeks to “… promote more studies that depict accounting as a social and institutional practice to enhance our understanding of the nature and determinants of the different dimensions of change in the context of this important calculative practice”. Suzuki (2003: 74), through his study, also highlights the need for further research in this area by stating that “the effects of financial and macroeconomic accounting on modern economic society have not been examined in depth from an epistemological and critical viewpoint”.
In light of these discussions, institutional economic theory seems to provide a promising foundation for further exploratory research into developing a theory of accounting. However, institutional economic theory within the context of holistic accounting practice has never before been tested within a South African setting. More specifically, as far as the available literature suggests, there have been no studies conducted which assess the institutional functionality of accounting practice in South Africa. Accordingly, the credibility of applying institutional economic theory to the development of accounting theory within a South African context remains an open area of enquiry. Therefore, it is the purpose of this study to assess whether or not accounting practice operates as an economic institution, in order to provide a foundation for further research into assessing whether institutional theory may be used for the development of an academically sound accounting basis of theory. The stated research question of this study can thus be described as follows:

**Does accounting practice in South Africa function as an economic institution?**

### 1.4 THE STATED RESEARCH OBJECTIVES AND METHODOLOGY

The research associated with this study is both exploratory and qualitative in nature. This study provides a holistic overview of the institutional features of accounting practice in South Africa which as far as could be established, is the first of its kind in South Africa. Accordingly, the notions expressed in this study are largely exploratory in nature. The study is also an exploration of social ideas rooted within the sphere of institutional economic theory for which qualitative examination is considered most appropriate.

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1 The value of this study is nevertheless meant to have international appeal and by focusing the research activities of this study on South Africa, the ability to achieve this is not impaired but instead, is enhanced by virtue of the quality of the regulatory environment that exists in South Africa. According to the *Global Competitiveness Report 2012-2013* issued by the World Economic Forum, the strength of auditing and reporting standards within South Africa ranks number one in the world, with the regulatory practices of South Africa’s securities exchanges also ranking number one worldwide (World Economic Forum, 2012: 325). Accordingly, the regulatory environment present in South Africa can almost be seen as a benchmark for such an analysis – “the perfect system” – if you will. In essence, by applying economic institutional theory to the “best” regulatory environment in the world, one is in a position to derive research results that have the potential to be of international relevance.
In answering the stated research question (being the main objective of the study) of assessing whether or not accounting practice in South Africa functions as an economic institution, a three-step approach was adopted. Each of the three steps represented a sub-objective which would have to be achieved before the main objective of the study could ultimately be fulfilled. In addition, each of these steps or sub-objectives was represented by an individual chapter in the study. These sub-objectives are described as follows:

**Sub-objective One (Chapter 2)**

In order to assess whether or not accounting practice in South Africa functions as an economic institution, it was firstly necessary to explain what “accounting practice in South Africa” means within the context of this study. In explaining “accounting practice in South Africa”, a description of the identity and functions of all the major role players within the accounting profession was provided. Once explained, the practice of accounting in South Africa was then diagrammatically represented. Lastly, a number of key elements of accounting practice in South Africa were extracted to be analysed in relation to the criteria of economic institutions that were established in Chapter 3. It was to these elements that the Chapter 3 criteria were applied in answering the research question of whether or not accounting practice in South Africa functions as an economic institution.

**Sub-objective Two (Chapter 3)**

Institutional theory is an area of study that is both broad and voluminous. Accordingly, it was necessary to state with sufficient specificity which areas of institutional theory were utilised in this study. This sub-objective therefore centred on firstly providing an outline of what institutional theory entails and which areas were utilised in this study. Secondly, this sub-objective focused on establishing a theoretical framework of characteristics which have to be present within a practice, system, or set of conventions, before such a practice, system, or set of conventions can be considered to be an economic institution. To establish this framework of characteristics, the principles of institutional economic theory were drawn upon.
Sub-objective Three (Chapter 4)

Once the elements for “accounting practice in South Africa” were established (sub-objective one), together with the established framework of characteristics of economic institutions (sub-objective two), the characteristics were then comprehensively applied to the established elements to provide a discourse and conclusion on whether or not “accounting practice in South Africa” can be academically regarded to be an economic institution.

The following diagram provides an illustrative representation of how all the key elements of this study link together.
**Stated Research Problem**
As it currently stands, there is no comprehensive, academically-sound theoretical basis on which to develop rules, principles and frameworks for the practice of accounting, which in turn, is able to serve the public interest.

In developing such a theory, it is necessary to understand the socio-economic dimensions of accounting. These are entrenched within concepts of influence and behaviour which form the foundation of institutional economic theory. Accordingly, institutional economic theory may be used as a basis to develop an accounting body of theory.

However, the institutional functionality of accounting practice has not been assessed within a South African context. The credibility in using institutional economic theory to develop an academic basis of theory within South Africa remains untested.

**Stated Research Question**
Does accounting practice in South Africa function as an economic institution?

**Stated Research Objective**
To assess if accounting practice in South Africa functions as an economic institution

**Sub-objective 1**
Explain accounting practice in South Africa and extract key practice elements

**Sub-objective 2**
Develop framework of characteristics of economic institutions

**Sub-objective 3**
Assess accounting practice in South Africa in relation to the established characteristics of economic institutions

**Conclude**
Accounting practice in South Africa does/do not function as an economic institution.

**Prompted Research Topic 1**
Explore the institutional functionality of individual role-players more extensively.

**Prompted Research Topic 2**
Establish an institutional model for the effective functioning of IFRS within particular jurisdictions.

**Prompted Research Topic 3**
Develop a theoretical framework for the practice of accounting founded on institutional thinking.

*Figure 1.4: Diagrammatic outline of the structure of this study*
1.5 MOTIVATION FOR THIS STUDY

As described earlier, the field of accounting in South Africa remains in a state of academic uncertainty. The result has been that accounting, as an academic discipline, has not evolved into an academically superior area of study, founded on the complex truths of widely acknowledged social and economic relevance.

Additionally, research output in South Africa within the field of accountancy is minimal, with genuinely inspiring scholarly contributions being of rare occurrence. Despite this however, there is an intellectually appealing view among certain academics that accounting is indeed built on an “elegant system that hints of a deeper reality” (Fellingham, 2007: 161). Accordingly, this serves to suggest that there is great potential for creative and innovative development within the field of accounting. The fulfilment of this potential however, lies in the hands of a new generation of creative and innovative researchers who are willing to bravely challenge the boundaries of “acceptable norms”.

The motivation of this study therefore, stemmed from the need to develop accounting into a discipline that is universally considered to be of great academic and social relevance. In addition, inter-disciplinary research and collaboration are objectives that this study also seeks to promote. By encouraging accounting academics to focus their research agendas on elements beyond the calculative and technical aspects of accounting practice, accounting as a regulatory practice has the potential to answer bigger and more serious economic and social questions. Indeed, accounting as a regulatory practice can be developed and enhanced to be an effective tool of social management, where what is accounted for, and to whom, can take on new levels of social relevance.

Therefore, by introducing the ideas and perspectives of this study to the academic world, it was envisioned that this study would serve as an area of new motivation for other academics to engage in research to develop accounting into an academic discipline of great interest, with strong social and economic significance.
1.6 POSSIBLE BENEFITS OF THIS STUDY

As discussed in more detail earlier, accounting currently does not have an academically sound theoretical basis for its practice, and with this come a number of consequences that have far-reaching effects for the development of academic work within accounting, as well as for the development of the profession as a whole.

Through the texts of others, it has been proposed that applying an institutional mindset to the development of accounting theory may result in innovative and more creative ways of establishing sound accounting principles of theory. By assessing whether accounting practice in South Africa functions as an economic institution, this study will play an important role in providing a foundation for other academics to engage in studies centred on further assessing the appropriateness of utilising institutional theory as a basis for the development of accounting theory, and perhaps even to take steps in developing such an accounting basis of theory.

Another envisioned benefit of this study lies in the inter-disciplinary research and collaboration that a study of this nature may establish, particularly between accounting academics and those from the discipline of economics. Currently, research and scholarly activity among South African academics in economics is much more established than in the field of accounting where, for instance, it was found that the average percentage of academics who hold doctorate degrees in economics departments in South African universities is 47% (Luiz, 2009: 2), whereas the average percentage of academics who hold doctorate degrees in accounting departments in South African universities is a mere 10% (Nieuwoudt & Wilcocks, 2005: 64). Therefore, by introducing research topics as being explored in this study, the socio-economic elements of accounting become more apparent to researchers within the field of economics.
1.7 LIMITATIONS AND DELIMITATIONS

1.7.1 Limitations

Although research of this nature has not been carried out before, there is a substantial amount of research material and peer-reviewed studies on each of the individual input elements needed to answer the research question at hand, and, as a result, there were no significant limitations to the completion of this study.

1.7.2 Delimitations

This study, as mentioned earlier, followed a fully theoretical approach. Accordingly, the scope of this study was limited to assessing, in accordance with a developed set of characteristics, whether or not accounting practice in South Africa can be considered to be an institution. Accordingly, the study did not focus on addressing issues beyond establishing such proof, for instance:

- Establishing solutions to any of the specific causes surrounding the absence of a theoretical base behind accounting practice in South Africa.

- Assessing the effectiveness of accounting practice in South Africa as an economic institution (i.e. whether or not accounting practice in South Africa effectively achieves the objectives that society expects its major role players to achieve).

- Providing specific recommendations on how to develop a theoretical basis for accounting practice in South Africa.
1.8 STUDY LAYOUT

This study was divided into five chapters, outlined as follows:

1.8.1 Chapter 1 - Introduction and Study Layout

This chapter provides an introduction to the research problem together with detailed discussions on what the consequences of the research problem are to both academia and practice, and hence the importance of addressing them. The chapter also describes what the specific research question is in relation to the research problem and in turn, what objectives the study seeks to achieve in relation to the research question. Also contained within this chapter, is information pertaining to the research methodology utilised to achieve the research objectives.

1.8.2 Chapter 2 - Accounting Practice in South Africa

In this chapter, “accounting practice in South Africa” is explained to establish an understanding of what this concept constitutes and thereafter, establishes a diagrammatic representation of the concept. The chapter then extracts and describes a number of key elements of “accounting practice in South Africa” against which the criteria from Chapter 3 will be applied.

1.8.3 Chapter 3 - The Characteristics of Economic Institutions

In this chapter, the areas of institutional theory that were dealt with in the study are described. Secondly, a generic set of characteristics is established against which structures, systems, and practices can be evaluated, in order to assess whether or not those structures, systems, and practices can be considered to be an institution from an economic point of view.
1.8.4 Chapter 4 - Accounting Practice in South Africa as an Economic Institution

The established concept of “accounting practice in South Africa” developed in Chapter 2, is applied to the characteristics established in Chapter 3 to arrive at a conclusion as to whether accounting practice in South Africa functions as an institution.

1.8.5 Chapter 5 - Conclusion

This chapter summarises the study’s sub-objectives and how they were achieved, in addition to the main objective of the study, and how that objective was achieved. Based on the conclusions, suggestions for future research are provided.
CHAPTER 2

ACCOUNTING PRACTICE IN SOUTH AFRICA

2.1 INTRODUCTION

In the previous chapter, it was established that the research objective of this study is to assess whether or not accounting practice in South Africa functions as an economic institution. In relation to this main objective, this chapter sets out to delineate the concept of “accounting practice in South Africa”.

In order to do so, this chapter has three sub-objectives. The first of these is describing the identity and functions of all the major role players that contribute to the practice of accounting in South Africa. Once this is achieved, the chapter then addresses its second sub-objective, being to diagrammatically represent how these role players interact with each other. The third sub-objective thereafter extracts a number of key elements from the delineated discussion on “accounting practice in South Africa”. The purpose of this extraction process is to derive a concise, structured and holistic set of points that represent “accounting practice in South Africa” to which the criteria of economic institutions (established in Chapter 3 and outlined in this chapter) may be applied.

2.2 THE MAJOR ROLE PLAYERS AND THEIR FUNCTIONS

2.2.1 The International Accounting Standards Board (IASB)

The IASB is an international body whose functions have a direct impact on accounting practice in South Africa. The IASB is an independent accounting standard-setting body based in London, England. The board was founded in 2001, and its primary function lies in the development and publication of IFRS and IFRS for Small and Medium-sized entities (IFRS for SMEs), which are essentially simplified IFRSs designed specifically for small to medium-sized entities (IASB, 2011). 

29
IFRS consist of the principles and rules for the accounting of transactions which
adopters of IFRS agree to abide by in the preparation and presentation of their
financial statements. In totality, IFRS collectively refer to the following:

- **International Financial Reporting Standards (IFRSs)** – consisting of those
  standards issued after April 2001;

- **International Accounting Standards (IASs)** – consisting of those standards
  issued before April 2001;

- **Interpretations from the International Financial Reporting Interpretations
  Committee (IFRIC)** – consisting of those interpretations issued after April 2001;

- **Interpretations from the Standing Interpretations Committee (SIC)** –
  consisting of those interpretations issued before April 2001; and

- **The Conceptual Framework for the Preparation and Presentation of
  Financial Statements (2010).**

In establishing these standards, the IASB engages in a formal, consultative process
with various stakeholders. The IASB states that “in fulfilling its standard-setting duties
the IASB follows a thorough, open and transparent due process of which the
publication of consultative documents, such as discussion papers and exposure
drafts, for public comment is an important component. The IASB engages closely
with stakeholders around the world, including investors, analysts, regulators,
business leaders, accounting standard-setters and the accountancy profession”
(IASB, 2011).

As it currently stands, 123 countries either require or permit the use of IFRS for their
domestically listed public companies (Deloitte Touche Tohmatsu Limited, 2011).

The IASB is governed by the IFRS Foundation, which in turn reports to a Monitoring
Board of various public capital market authorities. The IASB also engages closely
with two sister committees: the IFRS Advisory Council, whose purpose is to provide
strategic advice to the IASB, and the IFRS Interpretations Committee, whose
purpose is to provide interpretive guidance to the IASB.
For the purposes of this study, the IASB, the IFRS Foundation, its Monitoring Board and its sister committees are seen as one establishment with one primary role. Accordingly, the primary function of the IASB is to develop and publish IFRSs (and accompanying interpretations as necessary) that are to be used by adopters in the preparation and presentation of their financial statements.

From a South African perspective, all publicly listed companies are required to prepare their financial statements in accordance with IFRS by virtue of the regulations contained in the Companies Act 71 of 2008 (“the new Companies Act”) (SAICA, 2011) together with those regulations laid down by the JSE (JSE Ltd., 2011b: 8-3).

2.2.2 The South African Institute of Chartered Accountants (SAICA)

The South African Institute of Chartered Accountants (SAICA), founded in 1980, is the leading professional body responsible for the governing of a host of accounting-based qualifications in South Africa, including the Associate General Accountant ((AGA) SA), and Associate Accounting Technician ((AAT) SA), and the coveted Chartered Accountant ((CA) SA). For the purposes of this study, the influence of SAICA was considered only within the context of the Chartered Accountant (CA) profession, as this designation is considered to represent the foremost accounting qualification in South Africa (Wadee, 2010:6). Officially, SAICA (2008) describes their mission as follows:

The mission of SAICA is to serve the interests of the chartered accountancy profession and society, by upholding professional standards and integrity, and the pre-eminence of South African CAs nationally and internationally, by:

- Delivering competent entry-level members.
- Providing services to the members to maintain and enhance their professional competence thereby enabling them to create value for their clients and employers.
- Enhancing the quality and information used in the private and public sectors for measuring and enhancing organizational performance.
- Running and facilitating programmes to transform the profession and to facilitate community upliftment.
- Fulfilling a leadership role regarding relevant business-related issues and providing reliable and respected public commentary.

It can therefore be seen that SAICA’s primary function is to maintain the quality of accounting practice of its members. Accordingly, SAICA governs the training, the developmental, and to a certain extent, the performance requirements of its members. These governance regulations apply to a wide range of members from students pursuing the Chartered Accountant CA (SA) qualification to fully qualified CAs (SA) who operate within various areas of the private and public sectors. The role of SAICA is, therefore, deeply rooted in every stage of the developmental process of qualifying as a CA (SA). A brief outline of these roles appears below:

**Tertiary Education**

Students who wish to qualify as a CA (SA) are required to complete their tertiary education at a SAICA-accredited tertiary institution (university). To obtain this accreditation, a tertiary institution must comply with the training and education requirements of SAICA. In essence, this entails adopting the SAICA teaching syllabus as part of the institution’s academic programme for a prospective CA (SA).

**Professional Training**

Upon successful completion of the tertiary leg of the CA (SA) programme, a potential CA (SA) is then required to undergo professional training at a SAICA-accredited training institution. Typically, these institutions are either audit firms in public practice or other corporations within the private sector. In addition to the successful completion of this professional training, trainees also need to successfully pass two professional examinations with the first being governed by SAICA, and the second by the Independent Regulatory Board for Auditors (IRBA), for candidates who follow the auditing route in training.
Continuing Professional Development (CPD)

Once prospective SAICA members successfully meet SAICA’s tertiary and professional requirements, they may be admitted into the profession as a CA (SA). To maintain their membership, members are required to engage in various CPD learning activities in order to maintain their professional competence and abilities. Once again, this process is governed by SAICA. It is therefore apparent that the influence of SAICA on the practice of accounting in South Africa is indeed widespread. Therefore, as a role player within the practice of accounting in South Africa, the primary function of SAICA is to maintain, as a whole, the quality of accounting practice in South Africa.

2.2.3 The Financial Reporting Standards Council (FRSC)

The new Companies Act prescribes that the Minister of Trade and Industry is to establish a Financial Reporting Standards Council (FRSC), which will be responsible for advising the Minister on matters pertaining to reporting standards (PricewaterhouseCoopers International Limited, 2011: 7). The FRSC was established in late 2011, with its responsibilities being listed by SAICA (2012) as follows:

- To receive and consider any relevant information relating to the reliability of and compliance with financial reporting standards and adapt international reporting standards for distinctive local circumstances;
- To advise the Minister of Trade and Industry on financial reporting standards matters; and
- To consult with the Minister on regulations establishing financial reporting standards.

In essence, the FRSC considers the implications of utilising IFRS in South Africa and provides advice relating thereto to the Minister of Trade and Industry.
2.2.4 Legislation

South African legislation plays an important role in the way that accounting is practised in South Africa. A number of different Acts contribute to the regulatory function of accounting in South Africa by laying down legal requirements that specify, among other requirements: the need for companies to prepare financial statements; how they should prepare them; who should prepare them; and what sort of assurance activities need to be undertaken in relation to those financial statements. Other pieces of legislation specifically govern the audit profession, while some others lay down provisions that govern the functioning of South African financial markets. These types of legislation have been categorised and are discussed in greater detail below.

Apart from these broad categories of legislation, there is indeed a number of other Acts that have a bearing on the practice of accounting in South Africa. These, however, are not considered to be of primary importance to this study, and accordingly will not be addressed in the study.

2.2.4.1 Corporate Legislation

The most important piece of legislation governing the practice of accounting in South Africa today is arguably, the new Companies Act. This act was signed by South African President, Jacob Zuma, on 9 April 2009, and was gazetted in Gazette No. 32121 (Notice No. 421). Replacing the previous Companies Act 61 of 1973 ("the previous Companies Act"), this Act officially came into operation on 1 May 2011 (Grant Thornton, 2011: 2), bringing with it a number of new legal requirements pertaining to the responsibility of companies to prepare financial statements and undergo audits.

Accompanying the new Companies Act is the Companies Amendment Act 3 of 2011, which lays down certain provisions aimed at facilitating smoother administration in implementing the new Act. In addition, the 2011 Companies Act Regulations were also issued in order to provide implementation detail on certain provisions of the new
Act (Grant Thornton, 2011: 3). These documents will be collectively referred to as “the Companies Act”.

The Companies Act plays an important role within the framework of South African accounting practice, owing to the provisions relating to the financial reporting responsibilities and audit obligations of various companies governed by the Companies Act. The Companies Act distinguishes between companies of two types, namely “profit companies” and “non-profit companies”. The Companies Act further divides profit companies into four broad categories, being “state-owned companies”, “public companies”, “private companies” and “personal liability companies”. Non-profit companies are, in essence, the same as the previously known Section 21 Companies under the previous Companies Act.

For the purposes of this study, the regulations of accounting practice pertaining only to publicly listed companies will be considered. The rationale for this scope of limitation lies in the legal and professional regulations that govern the existence of public companies. As opposed to other types of companies, public companies are governed by the most arduous of regulations, and by performing the study’s assessment of the institutional functionality of accounting practice in South Africa on such companies, all the necessary regulations and role players are considered.

For publicly listed companies, there are three areas of the Companies Act that are of significant importance from an accounting point of view. The first area relates to the legal obligation of all publicly listed companies to prepare annual financial statements. The second area relates to the legal responsibilities of publicly listed companies relating to the set of standards which must be utilised in the preparation of those financial statements and the third relates to the legal obligations of such companies to undertake financial statement audits. These areas will be discussed in further detail below.

2.2.4.1.1 Preparation of Financial Statements

The Companies Act prescribes that all companies must prepare annual financial statements (South Africa, 2009: 76). The previous Companies Act stated that
financial statements had to be prepared within nine months of the company’s year-end, while the new Companies Act only allows for a comparable, six-month period after the company’s year-end. Accordingly, the obligation for all companies to prepare annual financial statements has not changed, but the time period within which these financial statements must be prepared, has.

The Companies Act also prescribes the need for prepared annual financial statements to “present fairly, the state of affairs” of the company and not to be “false or misleading in any material respect” (South Africa, 2009: 75).

2.2.4.1.2 Accounting Standards

The Companies Act also specifies which sets of accounting standards are available for use by various companies that are governed by the Companies Act. For public companies however, only IFRS are the accepted standards.

It is worth noting that in terms of the Companies Act there lie new regulations in the form of the so-called Public Interest Score (PIS). This mechanism requires all companies to calculate their PIS at the end of their financial year in accordance with the requirements laid down in Section 2 of the 2011 Companies Act Regulations (South Africa, 2011: 36). According to the Companies Act, and based on the score obtained, even certain private companies may be subject to the same accounting and audit regulations as public companies.

2.2.4.1.3 Audit Obligations

As a new feature of the Companies Act, the assurance activity requirements for different companies are also specified. While the previous Companies Act required all companies to undertake year-end audits, the new Companies Act creates a more “flexible regime” (SAIPA, 2011) in its requirements where again, companies that have lower public influence are afforded more flexible requirements, with companies having widespread public influence being required to fulfil more stringent obligations. In addition to these provisions, the Companies Act also specifies the type of parties that must be appointed to carry out the specified audit or independent review
procedures. Within the context of this study, as mentioned earlier, only public companies are considered.

2.2.4.2 Audit Legislation

The auditing profession in South Africa is governed by various pieces of legislation, with the most notable being the Auditing Profession Act 26 of 2005. The requirements of this piece of legislation are closely integrated with other professional regulations relating to the practice of auditors in South Africa. These legal and professional regulations are discussed in detail in the section entitled 2.2.7 Auditors and the Audit Function. Accordingly, please refer to this section for further discussion.

2.2.4.3 Financial Market Legislation

In respect of South Africa's formalised financial markets, there are laws in place that govern their activities as well. In particular, the Securities Services Act 36 of 2004 is of importance. However, only certain sections within this act are of relevance to the practice of accounting in South Africa and hence, will be discussed in conjunction with other areas of significance relating to financial markets, under the section entitled 2.2.8 Financial Markets.

2.2.4.4 Concluding Comments

The discussions in this section are meant to highlight the most important pieces of legislation that affect the practice of accounting in South Africa. In addition, the discussions are also meant to provide information on the specific provisions of these acts in order to provide an understanding of the legal requirements behind certain accounting practices. Therefore, as a role player within the practice of accounting in South Africa, the primary function of such legislation is to create legal backing for certain accounting practices.
2.2.5 Preparers of Financial Statements

As mentioned earlier, the preparation of financial statements is compulsory under the Companies Act. Accordingly, all companies have a legal responsibility to maintain proper accounting records and subsequently, to use these records to prepare annual financial statements. For public companies, these financial statements will be required by law to be prepared in accordance with IFRS. The preparation of such financial statements requires a fair amount of IFRS training on the part of the preparers and hence, in many instances (in South Africa), senior financial management and financial directorship posts are held by CAs (SA).

It is important to note that preparers effectively “create” the economic reality of their respective companies through the preparation and presentation of their financial information. The process is therefore one where there are distinct incentives for management to engage in certain accounting practices that are intended to achieve one or more pre-determined outcomes (these incentives will be discussed in chapters to come).

Nevertheless, as a role player within the practice of accounting in South Africa, the function of financial statement preparers is to prepare and present financial statements in accordance with IFRS and other regulations of the Companies Act.

2.2.6 Academics

The role of academics within the sphere of South African accounting practice was discussed at great length in Chapter 1. Accordingly, a further discussion on this will not be provided again. However, for the sake of maintaining structural order in this chapter, the role of academics within the practice of accounting in South Africa is stated as being central to providing accounting training to potential CAs (SA) in accordance with the teaching syllabi of SAICA.
2.2.7 Auditors and the Audit Function

The audit profession in South Africa is governed primarily by the Companies Act and the Auditing Profession Act 26 of 2005 (APA). As discussed previously, the Companies Act lays down certain provisions relating to which types of companies require audits, which require independent reviews, and which are exempt from these types of assurance obligations altogether. In addition, the Companies Act also lays down certain provisions for companies; how they must go about appointing an auditor, and what procedures need to be followed before such appointments can be terminated. The Companies Act also briefly addresses the legal rights and restrictions on auditors. Given the aims and objectives of this study, it is considered beyond the scope of this study to discuss these Companies Act regulations in detail. The APA on the other hand, prescribes a number of crucial legal regulations on auditors that will be discussed in further detail below.

To begin with, the APA provides for the establishment of the IRBA, whose members are appointed by the Minister of Finance. On an annual basis, these members report back to the Minister of Finance on their activities, who then tables the details of their report to parliament (IRBA, 2011). The IRBA therefore, serves as a statutory body commissioned to regulate the public accounting (auditing) sector of the accounting profession in South Africa, in accordance with the provisions of the APA. In essence, the IRBA serves as the APAs “enforcement” body.

The regulations that are enforced stem directly from the APA and cover a wide range of factors. For instance, an auditor who wishes to carry out the attest function in South Africa as a Registered Auditor (South Africa) (RA (SA)), is subject to the registration and accreditation regulations of the APA. The APA also outlines the accreditation regulations applicable to educational bodies who wish to provide professional audit training and development programmes. Included in the APA are also more specific regulations relating to the duties of auditors, and other factors pertaining to the way they are to conduct themselves as audit professionals.

4 For the purposes of this study, only aspects pertaining to statutory financial statement audits (as prescribed by the Companies Act 71 of 2008) will be discussed.
Arguably, the most important feature of the APA lies in the requirements of **Section 45 - Duty to Report on Irregularities**. Under this section, if an RA (SA) in practice is satisfied, or has reason to believe that a reportable irregularity has taken place or is taking place within an entity, he/she must report in writing and without delay to the IRBA, furnishing various details as required by the act. Failure to do so is punishable by law in the form of a fine, up to ten years’ imprisonment, or both (South Africa, 2006: 62).

Another important regulatory element of the auditing profession in South Africa lies in the auditing standards that are prescribed for use during the performance of statutory financial statement audits. SAICA, the professional body that governs the accounting profession in South Africa, is a member of the International Federation of Accountants (IFAC), which is an international accounting body consisting of approximately 164 members and associates in 125 countries worldwide (IFAC, 2011). Through the International Audit and Assurance Standards Board (IAASB) (which is the standard-setting arm of IFAC), IFAC issues audit standards which its constituent members apply in their respective jurisdictions. Since 1 January 2005, South African audit practice has been applying the entire set of IFAC auditing statements which are still used in practice today. These standards (which are applicable not only to statutory audits) consist of:

- International Standards on Auditing (ISAs)
- International Standards on Review Engagements (ISREs)
- International Standards on Assurance Engagements (ISAEs)
- International Standards on Related Services (ISRSs) (Bourne, Hamel, Marx & Van der Watt, 2009: 1-8).

The auditing standard **ISA 200 Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing** describes the official objectives of auditors as follows:

*In conducting an audit of financial statements, the overall objectives of the auditor are:*
(a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the ISAs, in accordance with the audit findings. (SAICA, 2009: ISA 200-3).

Therefore, as a role player within the practice of accounting in South Africa, the primary function of a financial statement audit is to express an opinion as to whether or not a set of financial statements fairly presents the financial position, performance and cash flows of an entity, in accordance with the requirements of IFRS.

2.2.8 Financial Markets

The South African financial market is a sophisticated one, rivalling the financial markets of some of the most developed economies in the world (IFAC, 2011). South Africa’s primary exchange is the JSE, founded in 1887. The JSE is Africa’s largest securities exchange (JSE Ltd, 2011a: 54) and the only African exchange to hold membership with the World Federation of Exchanges (WFE). The JSE is also ranked as the world’s 18th largest securities exchange by market capitalisation (South African Consulate General, 2011). According to the World Economic Forum’s Global Competitiveness Reports for the 2010-2011, 2011-2012 and 2012-2013 periods, the regulatory practices of South Africa’s securities exchanges ranked number one worldwide (World Economic Forum, 2010: 303; World Economic Forum, 2011:323; World Economic Forum, 2011:325).

Among other ancillary functions, the JSE mainly facilitates and regulates the trading of equity shares, derivatives and other similar instruments. In keeping with the aims of this study, only the equity trading leg (of companies publicly listed on the JSE) of the JSE will be dealt with, as it is within this area of the JSE that accounting practice regulations are of most relevance. From an accounting perspective, the JSE is also consistent with the new Companies Act, in that it requires its publicly listed entities to prepare annual financial statements in accordance with IFRS (JSE Ltd., 2011b: 8-3).
Recently, the JSE also initiated a more rigorous IFRS compliance monitoring function. In an announcement released by the JSE on 16 February 2011, the JSE publicised its decision to engage in a process of actively monitoring the financial statements of its publicly listed entities for compliance with IFRS. In the past, regulation of this nature was carried out only on a reactive, ad hoc basis in response to complaints of suspected non-compliance, or when similar concerns were noted by JSE staff.

This new monitoring system will entail the active reviewing of the financial statements of every publicly listed company on the JSE at least once every five years, in addition to the normal investigative processes associated with complaints or other concerns of non-compliance. The JSE will head this initiative, together with the support of the Department of Accounting at the University of Johannesburg (UJ) and the Financial Reporting Investigation Panel (FRIP). The JSE will select the names of companies to be reviewed and will pass on this information to the Department of Accounting at UJ, whose staff will then conduct the review. The results of the review process will then be forwarded to the JSE, which, based on the results obtained, will engage directly with specific companies. In instances where more complex matters are noted, the JSE may refer cases to the FRIP, as it has in the past (Varsity Lite Online, 2011). Accordingly, as a role player within the practice of accounting in South Africa, the primary function of the JSE is to ensure that its publicly listed entities comply with the financial reporting requirements of IFRS in the preparation and presentation of their financial statements.

2.2.9 Users of Financial Statements

The contention surrounding the identification and information needs of financial statement users was discussed in Chapter 1. The conclusion drawn from that discussion follows through into this section, where, currently, it is understood that

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5 The FRIP was previously known as the GAAP Monitoring Panel (GMP), and is an advisory body of accounting experts that was formed in 2002 by the JSE and SAICA to assist the JSE in enforcing company compliance with IFRS. The FRIP achieves this by dealing with cases of alleged non-compliance referred to it by the JSE. The role of the FRIP under this new process will continue as it has in the past.
properly conducted research has not to date been performed to understand comprehensively who the users of financial statements are, and what their information needs entail. At best, research has only been conducted in understanding perceptions of a predetermined set of users, towards financial statement formats already in use (Gray & Ratzinger, 2010).

In addition, it is of importance to note that it is not the purpose of this study to establish who these users are, nor is it to definitively provide evidence as to what their information needs are. Accordingly, for the purposes of this section, users and their information needs will be understood in the traditional sense as those that utilise financial statement information to assist them in making economic decisions.

2.2.10 Corporate Governance

The concept of corporate governance arose in the late 1980s in response to, as Bourne et al. (2009: 4-3) describe it, “the separation of ownership of companies from the control thereof”. In South Africa, the King Code of Governance for South Africa 2009, more commonly referred to as King III, is the code of corporate governance applicable to all companies (Bourne et al., 2009: 4-6). In addition, all companies publicly listed on the JSE are contractually bound to adopt King III in terms of the JSE’s listing requirements (Kennedy-Good & Pierce, 2012). As a result, the implementation of corporate governance principles is another important element that impacts accounting practice in South Africa.

It is important to note, however, that King III does not deal with specific matters pertaining to the preparation or audit of financial statements, but instead lays down supporting provisions to promote elements of fairness, accountability, responsibility and transparency in the way in which companies are managed and controlled (Bourne et al., 2009: 4-5).

While the available literature suggests that no formal studies have been conducted to assess the impact of King III on audit or accounting practices in South Africa, a host of international literature indicates that good corporate governance results in better financial reporting practices (Chen & Zhou, 2007; Dhaliwal, Naiker & Navissi, 2010;
Fich & Shivdasani, 2007). This notion will be explored from a South African perspective in Chapter 4.

2.2.11 Conclusion

The first sub-objective of this chapter was to provide a discussion on the identity and roles of all the major role players who are involved in the practice of accounting in South Africa. This sub-objective was met through the above discussions. The second sub-objective described was to represent these discussions diagrammatically in a summarised form. This diagram is provided in the following section.

2.3 DIAGRAMMATIC REPRESENTATION OF ACCOUNTING PRACTICE IN SOUTH AFRICA

In this section, a summarised description of the discussions provided in section 2.2 is provided along with a diagrammatic representation of this summary (Figure 2.1).

In Figure 2.1, it can be seen that the IASB develops and issues accounting standards (IFRS) that all publicly listed companies in South Africa are required to utilise in the preparation of their financial statements. However, before an IFRS standard is adopted for use in South Africa, the FRSC is meant to consider the appropriateness of the standard and provide advice on the standard to the Minister of Trade and Industry. The use of the IFRS in the preparation of the financial statements of publicly listed companies is governed by legislation and the JSE listing requirements, both of which processes are represented by the broken-lined circle in Figure 2.1.

Once these financial statements are prepared by public companies, they are then verified through an independent audit. The audit process is carried out in accordance with the rules of IFAC and is also governed by legislation. Once an audit is completed, the financial statements are released to various users who then utilise the financial information contained therein to assist them in making economic decisions. This process is represented by the dotted-line circle in Figure 2.1.
Preparing financial statements in accordance with IFRS requires technical IFRS training, and such training is often provided by tertiary institutions for students wishing to qualify as CAs (SA). The role of academics is therefore to train students to prepare financial statements in accordance with IFRS. This training is further carried forward during the professional training of potential CAs (SA). This entire process (with the exception of the JSE and legal regulations) is governed by SAICA through various degrees of involvement, as reflected by the solid-line circle in Figure 2.1 below.

![Figure 2.1: Diagrammatic Representation of Accounting Practice in South Africa](image-url)
2.4 THE KEY ELEMENTS OF ACCOUNTING PRACTICE IN SOUTH AFRICA

The third sub-objective of this chapter mentioned in the introduction was to extract from the explanations provided, a number of key elements which holistically encompass the major practices of accounting in South Africa.

A CA (SA) is trained in four core disciplines: those of accounting, auditing, financial management and taxation. Of those, the disciplines that are of primary importance to the practice of accounting in South Africa are accounting and auditing. Accordingly, based on this premise, the key elements of accounting practice in South Africa will be established.

The First Key Element

By analysing the above summary, it is clear that the act of preparing financial statements in accordance with IFRS (or IFRS for SMEs) is arguably the most significant feature of accounting practice in South Africa. It is in this specific element of accounting practice that all the major role players described earlier are involved. The IASB, along with other professional bodies, is responsible for preparing and/or reviewing the appropriateness of IFRS as a credible means through which to prepare financial statements. Through capital market regulations and legal rules, the act of preparing financial statements in accordance with IFRS is made compulsory, and professional bodies and tertiary institution focus their efforts on equipping people with the skills to assist companies in complying with these requirements.

Accordingly, the act of preparing financial statements in accordance with IFRS represents the first key element.

The Second Key Element

The preparation of financial statements in accordance with IFRS is matched in importance by the enforcement practices associated with ensuring that financial statements are prepared in accordance with IFRS. Upon analysing the summary above, it is clear that many of the major role players identified are also involved in this process. Both capital market regulations and legislation prescribe IFRS
compliance audits or reviews and a number of professional bodies ensure that these processes are both credible and conducted by suitably competent people.

Accordingly, the act of auditing financial statements for compliance with IFRS represents the second key element.

### 2.5 CONCLUSION

The overall objective of this chapter is to delineate “accounting practice in South Africa” through the fulfilment of three sub-objectives. The first sub-objective of this chapter was described as being to explain “accounting practice in South Africa” by providing a discussion on the identity and roles of each of the major role players in South African accounting practice. This was provided in section 2.2. The second sub-objective of this chapter was described as being to summarise the explanations provided and illustrate in diagrammatic form how accounting practice functions in South Africa. This was provided in section 2.3. The third sub-objective of this chapter was described as being to extract a number of key elements from the detailed explanation of accounting practice in South Africa, which will later be applied to the characteristics of institutions identified in Chapter 3, to ultimately assess whether or not accounting practice in South Africa functions as an institution. These key elements were extracted and discussed in section 2.4.

The overall objective of this study was to assess whether or not accounting practice in South Africa functions as an institution. In fulfilling this objective, this chapter has provided the necessary explanations of what “accounting practice in South Africa” consists of and further, which of the key elements of this practice were used to make this assessment. These key elements encompass firstly, the preparation of financial statements in accordance with IFRS and secondly, the audit of these financial statements for IFRS compliance.

In the following chapter, a set of institutional characteristics are established by engaging with literature from the field of institutional economics. These characteristics are then applied to the key elements of accounting practice in South Africa.
Africa (as established in this chapter) in order ultimately to assess whether or not accounting practice in South Africa functions as an institution.
CHAPTER 3

THE CHARACTERISTICS OF ECONOMIC INSTITUTIONS

3.1 INTRODUCTION

In Chapter 1 it was stated that the research objective of this study was to assess whether or not accounting practice in South Africa functions as an economic institution. Chapter 2 was centred on explaining “accounting practice in South Africa” and on identifying the key elements of this practice. These key elements were later assessed in relation to the characteristics of institutions in order to ultimately assess whether or not accounting practice in South Africa does indeed function as an institution.

In this chapter, these “characteristics of institutions” will be established by drawing on principles that currently exist within the body of knowledge surrounding institutional economics. In establishing these characteristics, this chapter firstly provides a discussion on what the field of institutional economics consists of, and which areas of this field the study will engage with in arriving at the characteristics to be established.

Accordingly, this chapter has two sub-objectives. The first sub-objective is to provide an explanation of what institutional economics consists of, and to define the areas of this field that were considered in the study. The second sub-objective is to draw on the principles noted in studies within the areas of institutional economics defined through sub-objective one, and to establish a set of characteristics that in theory should be present within a practice, norm or convention before such a practice, norm or convention can be considered to be an economic institution.

3.2 THE FIELD OF INSTITUTIONAL ECONOMICS

Many economies around the world continue to face significant economic and developmental challenges. Today, even developed economies face the hardships of economic decline in light of the financial crisis that has placed many advanced economies around the world under severe financial strain. Mainstream economic
theory has not been able to successfully address or prevent these global economic conditions and has once again brought to the fore widespread debate on the value and usefulness of conventional economic theory (Asensio & Lang, 2010; Belingher & Moroianu, 2011; Cretu, Marginian & Stanef, 2011; Kirman, 2011; Yao & Zhang, 2011).

Concerns over mainstream economic theory are, however, by no means recent developments. The oversimplified and unrealistic assumptions that are prevalent in many areas of economic theory (termed broadly as neo-classical economic theory) were identified as being problematic in the late 1800s, through the works of Thorstein Veblen (1899) and later John Commons (1931), who in response to these concerns, established the first discussions on institutional thinking (Chetty, Greyling, Schoeman, Van Zyl & Wentzel, 2005: 210). Later termed as “Old Institutional Economics” (OIE), these views on institutional economics were primarily concerned with “describing institutions rather than with analysing them” (Benham, 1997). In essence, these early discussions introduced a paradigm shift in the way economists viewed economic theory and “gave us imaginative insights, perceptive description, [and] quantitative management” (North, 1992: 3). However, these ideas did not provide any definite theoretical framework (North, 1992: 3). Klein (1999: 457) points out that this view was echoed by Coase (1984: 230) where, in relation to OIE, he rather dismissively proclaimed that “without a theory they [the old institutional theorists] had nothing to pass on except a mass of descriptive material waiting for a theory, or a fire”.

The “New Institutional Economics” (NIE) movement arose through the studies of Ronald H. Coase (1937; 1960) which were later developed further through the works of Douglass C. North and Oliver E. Williamson. Today, NIE forms the basis of most studies within the sphere of institutional economics. Like the OIE, NIE also deals with social, economic and political institutions (Klein, 1999: 457), but differently: NIE

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6 Ronald H. Coase was awarded the Alfred Nobel Memorial Prize in Economic Sciences in 1991 for his work in property rights and transaction costs in relation to the need for economic institutions.

7 Douglass C. North was awarded the Alfred Nobel Memorial Prize in Economic Sciences in 1993 for his work in explaining institutional change.

8 Oliver E. Williamson was awarded the Alfred Nobel Memorial Prize in Economic Sciences in 2009 for his work in the field of economic governance.
eases the boundaries of certain assumptions that prevail in OIE (Locatelli & Rossiaud, 2010: 3). Accordingly, through a more complex set of methodological principles and criteria, NIE provides the theoretical basis for the application of institutional theory that the early founders of the OIE did not provide.

In light of the above discussion, it is of importance to note that institutional theory (new and old) is by no means perfect and a significant volume of literature exists in relation to their respective merits and demerits. It is not the purpose of this study to engage in or actively contribute to that discourse. Instead, the purpose of this study is to draw on elements from the already existing body of knowledge to establish a basic set of characteristics that are believed to be present in institutions that can be applied to the practice of accounting in South Africa to assess whether or not this practice functions as an institution. In establishing this framework of characteristics, all elements from both the OIE and NIE were utilised.

3.3 CHARACTERISTICS PRESENT IN ECONOMIC INSTITUTIONS

This section establishes a set of characteristics that in theory should be present within a practice, norm or convention, before such a practice, norm of convention can be considered to be an economic institution.

Among economists, there is no formal consensus on what “economic institutions” are. However, as pointed out in the work of Davis (2010), there is a fairly broad consensus on what economic institutions are not. It is widely agreed among scholars that institutions are neither natural nor environmental features (such as lakes or mountainous passes), nor are they physical or man-made structures (such as highways or factories). Instead, they are the features of a population. Again, however, they are neither the natural features of a population (such as intelligence or cognitive ability) nor are they the physical ones (such as height or strength). What economic institutions actually refer to are the behavioural elements of a population that are reflected in their everyday interactions (Davis, 2010: viiii), which highlight the foundation of institutional thinking, being the “relation of man to man” (Commons, 1931: 652).
3.3.1 Behaviour

In one of the earliest twentieth-century works done on institutional thinking, Commons (1931: 649) defined an institution as “collective action in control, liberation and expansion of individual action”. Central to this definition was the element of “control” which he described as being a means through which one can direct “economic behaviour”. It is this ability to “control” that influences what an individual “can” or “cannot do”, “must” or “must not” do or “may” or “may not” do (Commons, 1931: 650). Therefore, it is through these institutions that the behaviour of individuals can be influenced. Institutions are therefore behaviouristic in nature and, specifically, relate to the behaviour of individuals (Commons, 1931: 654).

The existence of this behavioural characteristic of institutions is also echoed in more recent studies. Peukert (2001: 93) states that “there can be no doubt that individual behaviour shapes social institutions and the other way round”, while Davis and Wiggins (2006: 1) state that institutions “condition and modify the behaviour of individuals and groups so that their actions become more predictable to others”.

It appears that the primary role institutions play in the socio-economy lies in the influence they have over individual and collective behaviour. The manner in which this is achieved and the forms of influence they assume are further characteristics that are described in sections to follow. Nevertheless, it can be accepted that as a minimum, universal consensus exists among institutional economists that the most basic characteristic of institutions lies in their ability to influence the behaviour of individuals and by implication, population groups as well.

The first important characteristic of an institution can therefore be described as follows:

*An institution influences the behaviour of individuals who are exposed to it.*
3.3.2 Incentives

In the previous section, it was mentioned that institutions go about a process of influencing human behaviour. The degree of success to which institutions achieve this, lies in the incentives that they create. Chetty et al. (2005: 209) state that “institutions create incentives to motivate people to stick to certain kinds of behaviour or to avoid other kinds of behaviour”. In his study on the evolution and effect of institutional structures through time, North (1991: 97) states that “institutions provide the incentive structure of an economy; as that structure evolves it shapes the direction of economic change towards growth, stagnation, or decline”.

Chetty et al. (2005: 209) provide examples of this where they state for instance, that the law of a country lays down certain rules that influence people to engage in certain behaviours and abstain from others. A harsh prison sentence for example, would discourage a person from committing murder as the incentive for committing the crime would in most instances not outweigh the negative consequences of committing it. Private property rights are another area that creates incentives for people to engage in certain activities and abstain from others. If a country has well-defined and strongly enforced private property rights, this incentivises people to engage in economic activity involving the production and exchange of privately owned property, as they are certain that their property will not be unjustly taken away from them. In scenarios where such rights don’t exist or are weakly enforced, people are not incentivised to produce and acquire property, thus constraining economic activity.

Therefore, it is clear that institutions are deeply rooted in understanding human behaviour and how it is influenced through incentives. The means through which institutions influence human behaviour thus lie in the incentives that they create.

The second characteristic of an institution can therefore be described as follows:

An institution creates one or more incentives as a means to influence human behaviour.
3.3.3 Certainty

It was stated in an earlier section that in response to the problems associated with neo-classical economic theories, the early founders of institutional thinking proposed institutionalism as an alternative theoretical mind-set that could be used to solve economic problems. Chetty et al. (2005: 208) point out that the problems these neo-classical theories did not address in practice, stemmed from the assumptions that these theories were founded on. For instance, some included theories based on “rationality” and “perfect information” where individuals were assumed to know with certainty the most efficient decisions they could make, that they had access to the kind of information that would enable them to make those decisions, and thus, would always make them, resulting in the most efficient outcomes for themselves and society as a whole.

Perhaps the most significant characteristic of institutions therefore, lies in their ability to address these problems though establishing greater levels of certainty and predictability within economies.

Institutions by their very nature go about addressing one or more of the real-world problems that neo-classical economic theory does not recognise. For instance, Davis (2010: xv) quotes the work of Rodrik (2000) whose study engages with the important functions institutions play in ensuring “social cohesion and stability”. Locatelli and Rossiaud (2010: 4) also support the view that institutions create greater levels of certainty by unequivocally stating that “institutions allow the decreasing of uncertainty which is faced by individuals” and that “rules, whether formal or informal, ‘domesticate’ uncertainty in the human environment”. They further go on to explain this view by stating that institutions, through the incentives they create, limit or constrain the choices of individuals.

It is through these constraints that institutions create that the decisions and behaviour of individuals can be more easily predicted. Davis and Wiggins (2006: 2) echo this view by arguing that “institutions are created and evolve in response to the uncertainty, risk and information costs associated with living and transacting in an imperfect world”.

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Chetty et al. (2005: 209) describe various real-world problems that neo-classical economic theory overlooks, and further describe how these problems are addressed by institutions. In each case, institutions act to reduce uncertainty and increase predictability. With regard to the earlier discussed “perfect information” assumption for instance, they state that in the real world it is impossible to have such information, and that by lacking such information one is exposed, for example, to the risk of cheating, deception and manipulation on the part of certain economic participants who are incentivised by the prospect of obtaining more favourable economic benefits over others as a result of engaging in these undesirable practices. Imperfect information can thus make consumers susceptible to purchasing defective goods or to entering into contracts that have unfair terms.

Institutions create mechanisms to prevent events like these from taking place, by offering protection to consumers and allowing them to institute recourse action against perpetrators. These institutions usually take the form of legislation, with two recent pieces of this nature having been introduced in South Africa: first the Consumer Protection Act 68 of 2008, and second the National Credit Act 34 of 2005. By having these institutive rules in place, the behaviour of individuals can be better predicted, as it is expected that most individuals would abstain from dishonest action. By implication, a greater degree of certainty is created in the socio-economy.

Chetty et al. (2005: 212) explains that social conflict occurs in many economies for a number of reasons which neo-classical economic theory does not effectively account for. It is through production that an economy creates its wealth and those who are involved in the production process are entitled to a share in the wealth proportionate to their contribution. They further explain that in reality, however, interest groups form (for example, firms and labour unions), and, based on their bargaining power, secure larger portions of the wealth than they are entitled to. An increase in the wealth secured by one interest group naturally results in a decrease in wealth secured by another, and this has the potential to cause social conflict where some interest groups who feel cheated or ignored, will retaliate against those groups whom they feel are cheating or ignoring them. In South Africa, for instance, improved public transport initiatives like bus services and railway projects are often met with hostile resistance by taxi drivers who traditionally have always dominated the public
transport industry. Resistance between interest groups creates uncertainty in the market and disturbs its efficient functioning. Wage disputes between employers and employees, public service protests against the government and demonstrations against legal rulings of public interest, are all examples of social conflict that disrupt smooth production in the market. Institutions assist in addressing these potentially disruptive acts by affording wider representation of interest groups in the market. For instance, free elections and a democratic political system are institutions that give all interest groups representation in government and hence assist in preventing minority interest groups from being ignored or exploited. By having institutive mechanisms in place, a country is able to prevent (with varying degrees of success) such acts from occurring, thereby allowing its economy to have more predictable, stable and certain operating conditions.

Another important characteristic of institutions therefore, lies in their ability to maintain certainty in an economy. The third characteristic of an institution can be described as follows:

*An institution assists in decreasing the uncertainty associated with human interaction.*

### 3.3.4 Durability

Institutions would not be able to improve certainty and influence behaviour if they were only applicable for a short space in time or if they could be easily changed. Institutions need to be durable, which refers to “length of operation” and “susceptibility to change”.

An institution that is not believed to be durable may create uncertainty rather than certainty. A good example of this is the government that was run by former American President, George W. Bush, whom many regard as not having been institutive by nature (Glaeser, La Porta, Lopez-De-Silanes & Shleifer, 2004: 275), given his policies on invasion and war, which were not only short-term, but also created significant levels of uncertainty within the American economic system.
Davis and Wiggins (2006: 2) further expand on the durability aspect of institutions by stating that institutions, by their nature, favour certain interest groups over others. If an institution is not durable, it could simply be changed by those interest groups that are not in favour of them. In contrast to this, it is of equal importance that institutions are not so rigid and inflexible that they cannot be changed in the best interests of the majority as events arise and circumstances change. Aptly, they quote the words of Hodgson (2001), who states that “essentially, institutions are durable systems of established and embedded social rules and conventions that structure social interactions”.

The fourth important characteristic of an institution stems from its ability to demonstrate durability, which can be formally described as follows:

*An institution demonstrates durability or permanence where it cannot be changed frequently or easily and hence, does not change easily or frequently.*

### 3.3.5 Constraints

It was stated earlier that institutions influence behaviour through the incentives they create. Such incentives are created through the concept of “constraint” where North (1994: 360), for instance, describes institutions as the “…humanly devised constraints that structure human interaction. They are made up of formal constraints (e.g. rules, laws, constitutions), informal constraints (e.g., norms of behaviour, conventions, self-imposed codes of conduct), and their enforcement characteristics”.

Based on this definition it can be seen that institutional constraints can be either formal or informal. Davis (2010: xv) provides a simple way of making the distinction by stating that “formal institutions are endorsed by the state, the rest are informal institutions”. In addition, another distinction is made between institutional constraints and the institutions that enforce those constraints. For instance, criminal law creates legal constraints for human interaction and the police force enforces those legal constraints. Both the law and the police force are nevertheless institutions. One creates the rules, the other enforces them.
This last characteristic of “constraints” therefore lies in the mechanism used to create incentives as well as the nature or form that such mechanisms may take.

The fifth important characteristic of an institution therefore, can be described as follows:

An institution provides constraints or enforces constraints through either formal or informal means.

3.4 CONCLUSION

This chapter set out to firstly provide a brief description of what the field of institutional economics consists of and from this description outlined which areas were utilised in this study. This description was provided in section 3.2, and it was established that all areas of the OIE and NIE were considered in this chapter.

The second objective of this study was to provide a framework of characteristics which would theoretically need to be present within a practice, norm or convention before such a practice, norm or convention could be considered to be an institution. These characteristics were established in section 3.3 and in summary, relate to principles of behavioural influence, incentives, certainty, durability and constraints. It is important to note however, that these characteristics by no means represent an exhaustive list. In formulating these characteristics, care was taken to identify and mention only those characteristics that at a basic level are widely agreed upon by institutional economists to be present in all institutions.

While institutional economists describe many other features of institutions that this study does not mention, these are characteristics that also form the subject of widespread debate. As mentioned earlier, the purpose of this chapter is not to actively contribute to this debate, hence only those characteristics that have widespread consensus have been mentioned here.

In the following chapter, these characteristics are applied to the key elements of accounting practice in South Africa identified in Chapter 2 to fulfil this study’s
research objective of assessing whether or not accounting practice functions as an economic institution.

In concluding this chapter, a definition for institutions based on the characteristics established above, is provided as follows:

Institutions are durable constraints and incentives that human beings place on each other, aimed at influencing the behaviour of individuals exposed to them, in order to minimise the uncertainty that human interaction creates.
CHAPTER 4

ACCOUNTING PRACTICE IN SOUTH AFRICA AS AN ECONOMIC INSTITUTION

4.1 INTRODUCTION

The objective of the study, as outlined in Chapter 1, was to assess whether or not accounting practice in South Africa functions as an economic institution. Chapter 1 further outlined that in order to achieve this objective the study followed a qualitatively based, three-step approach. The first step, which was addressed in Chapter 2, identified the major role players within the field of accounting in South Africa and thereafter explained what their roles consisted of. The second step, addressed in Chapter 3, developed a set of criteria which are generally agreed among institutional economists to be present in most functioning economic institutions.

The third and final step of the study was the application of the criteria outlined in Chapter 3 to the key features of accounting practice in South Africa which were outlined in Chapter 2, in order to fulfil the study’s research objective of concluding on whether or not accounting practice in South Africa does indeed function as an economic institution. Accordingly, it is the objective of this chapter to discuss and assess the institutional functionality of accounting practice in South Africa.

4.2 THE INSTITUTIONAL FUNCTIONALITY OF ACCOUNTING PRACTICE IN SOUTH AFRICA

The outcome of Chapter 2 indicated that there are two key elements of accounting practice in South Africa. The first of these was the preparation of financial statements in accordance with IFRS.

This preparatory process is undertaken through a number of local and international role players. The IASB and the IFRS standards that they issue form the foundation of this preparatory process; as it is, these standards are utilised in the preparation of financial statements by all publicly listed companies in South Africa. However, before
an IFRS standard is adopted for use in South Africa, the FRSC plays an important role in considering the appropriateness of the standard for South African conditions and advises the Minister of Trade and Industry by reporting on matters of wider economic significance. This leg in the preparatory process is one of great importance as it allows for rational and careful scrutiny of international standards while at the same time affording consideration to their potential impact on businesses within the context of local economic realities. The utilisation of IFRS in this preparatory process is prescribed by legislation through provisions laid down in the new Companies Act. In addition, this prescription is also enshrined through market regulations as a requirement of the JSE that is applicable to all its publicly listed companies. The preparers of financial statements play the final and most visible role in the preparatory process through the practices they undertake in reporting the financial results of the companies they represent.

The second key element was described as the audit of these financial statements in order to provide assurance on the level of compliance with IFRS in their preparation. Owing to the size and complexity of the financial operations of publicly listed companies, this audit process is usually undertaken by sizeable and well-established audit firms. In South Africa, the independent audit process is to be undertaken in accordance with professional regulations laid down by the IRBA. In addition, legislative rules prescribed by the new Companies Act and the APA also lay down certain provisions which govern the way in which independent financial statement audits are to be carried out.

The outcome of Chapter 3 was thus the generation of a set of generally agreed upon criteria which are present in all economic institutions. These were identified as centring on characteristics of certainty, incentives, behaviour influence, durability and constraints. In the sections that follow, these characteristics were applied to the two key elements described above in order to conclude on whether or not accounting practice in South Africa can be considered to be an economic institution.
4.2.1 Key Element 1 - The Preparation of Financial Statements in accordance with IFRS

As mentioned previously, all publicly traded South African companies face the legal responsibility of preparing financial statements in accordance with IFRS. This legal responsibility can be broken down into firstly, the act of preparing financial statements (irrespective of how it is done) and secondly, the act of utilising IFRS in that preparatory process.

As pointed out by Wysocki (2011: 6), the act of preparing financial statements is widely considered to be an important institution. Arguably the most important feature of accounting information lies in its ability to influence economic decision-making through the provision of financial information that is useful in making more efficient economic decisions. In simpler transactions, the importance of accounting information may not be immediately apparent, but as economic exchanges take on higher levels of complexity, the importance of accurately accounting for them increases as well. This belief is echoed through the work of Benston (1984: 48) where he quite simply says that “modern commercial and industrial practice owes its existence to the creation of accounting”.

Accordingly, modern day accounting information creates certainty in the market through the financial control it affords various parties. However, in order to provide this certainty, accounting information needs to be of good quality and as a result, meet the information needs of users. The question therefore arises as to whether or not the application of IFRS results in the provision of financial information that is of suitable quality to create certainty in the market. The IFRS Foundation (Deloitte Touche Tohmatsu Limited, 2012) state as part of their objectives that they aim:

To develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world’s capital markets and other users of financial information make economic decisions.
Consequently, financial information prepared in accordance with IFRS should serve to facilitate market efficiencies through the provision of useful information to the users of such information, which enables them to make more efficient decisions. Such information should serve as a social and economic management tool that regulates economic behaviour in the market by preventing economic inefficiencies. In essence, IFRS-prepared financial information should allow for a smooth and continual flow in market activity by creating certainty in practice. In assessing the ability of IFRS-prepared financial information to do this, the characteristics of institutions identified in Chapter 3 were applied to this practice.

4.2.1.1 Certainty

Arguably the most valued characteristic of an institution is its ability to reduce uncertainty in the market. Proponents of IFRS claim that the uniform application of IFRS results in improved transparency and enhanced comparability (Ballas, Skoutela & Tzovas, 2010: 931) of financial information, resulting in more predictable and stable accounting practices (and hence better quality financial information), which in turn creates greater certainty in the market.

Within a South African context, this view is also held by the profession’s highest regulatory body - SAICA. In endorsing the use of IFRS by publicly listed South African companies, SAICA states that enhanced reliability, comparability, and consistency of financial information are the expected benefits of IFRS application, which in turn improves the decision-usefulness of this information for users, preparers and investors alike (Ludolph, 2006).

In response to these assertions, (Jeanjean & Stolowy, 2008: 482) state that IFRS does not necessarily provide increased transparency; they counter-argue that single-set accounting standards often make it difficult for preparers to convey financial information effectively if they are governed by preparatory regulations that do not factor in the local institutional features of their particular jurisdictions. This results in the preparation of financial information that is quite often cumbersome and of little use to users of that information.
Interest earnings in relation to Muslim countries provides an apt example. According to Shariah Law, Muslims may not earn interest funds. In making an investment decision, it is also not permitted for Muslims to invest in companies that generate impermissible earnings (according to Shariah Law) that exceed a certain percentage of the company’s total earnings (The Milli Gazette Online, 2005). Accordingly, for such users of financial information who are involved in assessing companies for potential investment, a figure such as “interest income” should represent only those funds that were actually earned as interest. However, according to IFRS, which operates under the accrual basis of accounting, certain revenue transactions that incorporate deferred payment terms are required to be accounted for in part, as financing transactions. As a result, a portion of the sales price must be recognised as “interest income” as opposed to “revenue”. From a Shariah perspective, this form of “interest income” is not interest income per se and hence, must be stripped out of the interest income figure that appears on the income statement before the assessment of investment permissibility can be made. In the absence of sufficient information to make this distinction of differently natured interest incomes, the information needs of the user are not met, as the type of transparency needed by the user to make such a specific economic decision is not available nor prescribed under IFRS.

Jeanjean and Stolowy (2008: 482) also argue that comparability and hence, certainty is not necessarily achieved through the widespread application of IFRS, owing to the subjective nature of the accounting standards and the ample room for discretionary application that the standards allow. They conclude that IFRS alone will not harmonise accounting practice, nor does it result in greater transparency and comparability.

Within a South African context, these arguments on subjective practice also hold true where for instance, it is stated by Buys and Schutte (2011: 56), that owing to the vast cultural diversity that exists across the South African social landscape, the application of IFRS in this country is also susceptible to “cultural interpretation”.

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1 Shariah Law is the divine law of Islam that Muslims follow. Shariah Law is applied in many Islamic states and strongly influences various social and economic behaviours within those jurisdictions.
In light of these arguments it is reasonable to state that IFRS alone do not create certainty in the market. This, however, does not rule out the view that in conjunction with other regulatory mechanisms such as clearly defined and strongly enforced financial reporting legislation, properly conducted financial reporting audits, and by integrating local institutions into financial reporting regulation, IFRS may indeed be a strong contributor to market efficiency and hence, economic certainty. This view is indirectly echoed by many scholars who through their findings concluded that better-quality financial standards do not result in better financial information when the necessary enforcement bodies are not effective (Ball, Robin, & Wu, 2003; Burgstahler, Hail, & Leuz, 2006).

A comprehensive study undertaken by Barth, Landsman, and Lang (2008) that involved companies from 21 different countries revealed that those companies who applied IFRS in their financial reporting demonstrated lower levels of earnings management, income smoothing, and more timely loss-recognition (and hence, better accounting quality). In addition, those companies also indicated a stronger association between accounting amounts and share prices. However, the findings specified an important caveat. The superior quality of financial information that the IFRS-practicing companies demonstrated was not merely as a result of applying IFRS alone, but instead resulted from a combination of IFRS with other factors such as the interpretation of IFRS in its application, together with the legal and other enforcement conditions that those companies were subjected to.

Bradshaw and Miller (2008) conducted a similar study which involved companies from 27 different countries. They found that effective regulatory oversight would be important in achieving globally converged standards and that such oversight also enabled better comparability of financial information. In another study conducted by Ojo (2010), which analysed the role of accounting standards in relation to the financial crisis of 2007 to 2009, the results revealed that appropriate enforcement mechanisms are vitally important in applying a “principle-based” set of standards such as IFRS. Given the latitude for judgment and subjectivity that such a set of standards provides to its adopters, she concluded that successful and comparable accounting practices are dependent on the enforcement mechanisms that accompany the application of IFRS, thereby hinting at an interesting finding echoed
in the words of Holthausen (2003: 275), where he states that it may very well be the case that “standards matter little and institutions matter a great deal”.

The quality of South Africa’s auditing and reporting standards is held in high esteem internationally. This is by virtue of the number one ranking South Africa has successively achieved on this indicator in the World Economic Forum’s Global Competitiveness Reports over the past three years (World Economic Forum, 2010: 303; World Economic Forum, 2011: 323; World Economic Forum, 2012: 325). In addition, the quality of South Africa’s financial market development is also held in high regard globally, as evidenced through the overall number three ranking obtained in the 2012 Global Competitiveness Report (World Economic Forum, 2012: 324). These indicators are indicative of the robust and well regulated financial markets within which South African businesses operate, and, in addition, the high levels of financial market stability and certainty upon which these business activities are undertaken.

An important contributor to this certainty can be attributed to the quality of accounting practice in South Africa. However, one cannot simply attribute this high quality of accounting practice to the mere fact that IFRS application is mandatory for all South African publicly listed companies. In a study conducted by Ossip (2011), the quality of financial information from financial statements prepared under South African Generally Accepted Accounting Practice (SA GAAP) was compared to the quality of financial information prepared in accordance with IFRS. The result of the study indicated that there were no scientifically credible reasons to conclude that the adoption of IFRS in South Africa had resulted in superior accounting information since its adoption in 2005.

Despite this, the confidence and certainty in South Africa’s financial markets has increased over the last while (World Economic Forum, 2010: 303; World Economic Forum, 2011: 323; World Economic Forum, 2012: 325), with this period of increase coinciding with South Africa’s post-IFRS adoption period. With South African accounting practice being an important contributor to this improvement in financial market certainty, combined with the assertion that IFRS application alone has not enhanced the quality of this practice, it is reasonable to surmise that the supporting
institutional mechanisms have played, and continue to play, an important role in strengthening the quality of accounting practice in South Africa.

For example, the education and training of accounting professionals in South Africa follows a rigorous and tightly regulated system headed by SAICA (Verhoef, 2012: 29) and in some areas by the IRBA. In order to obtain the coveted CA (SA) designation, candidates must successfully complete a host of academic and professional examinations as well as undergo a period of professional training. This system results in the emergence of accounting professionals that are specifically trained within the ambit of core accountancy disciplines and hence enter the work market with specific accountancy experience. This system differs somewhat to other professionally regulated systems where, for instance, a formal accounting degree is not a prerequisite for entrance into the professional training programme governed by the Institute of Chartered Accountants in England and Wales (ICAEW) (Verhoef, 2012: 5). This rigorous training system ensures that prospective accounting professionals in South Africa are well trained in the accounting disciplines before being allowed entrance to the market as accounting professionals. As qualified accounting professionals, members of SAICA must undertake “continual professional training” to “develop and maintain their professional competence” (SAICA, 2012). This in turn serves as an important mechanism in developing and maintaining the professional skills of accounting professionals in South Africa.

One of the concerns discussed earlier centred on the view that the application of IFRS is susceptible to subjective application and that if local institutional features of particular jurisdictions are ignored, the application of IFRS within those areas would not result in the production of comparable, consistent and decision-useful information. To address this, South Africa has in place the FRSC whose main function is to assess the appropriateness of the IFRS within a South African context, before their adoption. The FRSC was formulated only in 2011, and its effectiveness in ensuring quality accounting information in South Africa is yet to be established.

Another important institutional feature of accounting practice in South Africa that contributes to the creation of market certainty lies in the legal backing of the requirement for all publicly listed companies to prepare their financial statements in
accordance with IFRS. In the past, South African legislation did not formally prescribe publicly listed companies to apply codified financial standards in the preparation of their financial statements (The University of Johannesburg (UJ), 2012: 6). Among other problems, this created an environment conducive to divergent accounting practices within the market (UJ, 2012: 6), which in turn contributed negatively to market certainty.

In summary, it is expected that by implementing principle-based accounting standards such as IFRS, numerous challenges will come to the fore. However, many studies (as discussed previously) conclude that by combining strong mechanisms to enforce and monitor the application of IFRS, the requirement to prepare financial statements in accordance with IFRS does indeed result in better quality financial information. This in turn creates greater levels of certainty in the market, and, based on the previous discussions, South Africa serves as a suitable case in point.

4.2.1.2 Incentives

Available literature which discusses matters pertaining to the current quality of accounting information mainly centres on issues pertaining to the quality of accounting standards and their supporting mechanisms (Ball et al., 2003; Ballas et al., 2010; Jeanjean & Stolowy, 2008).

In their study, Burgstahler et al. (2006: 984) state that another crucial element believed to affect the quality of accounting information, though often overlooked by standard setters, lies in the incentives that preparers of such information are exposed to. They further state that by applying principle-based and hence subjectively influenced accounting standards, it is within the control of preparers to provide accounting information that is either informative or that fulfils more “benign interests”. Accordingly, in successfully introducing and operating enforcement mechanisms to ensure the appropriate application of IFRS, an understanding of the influences that preparers are exposed to becomes an exercise of great importance (Burgstahler et al., 2006: 986).
Both locally and abroad, various market influences create incentives for preparers to engage in misrepresentative accounting practices. For instance, companies in financial distress are strongly incentivised to manipulate reported information to avoid any interventions from creditors. Analysts’ forecasts also create incentives for management personnel to present a pre-determined picture of an entity’s financial health (Fischer & Stocken, 2004: 847). Firth, Rui and Wu (2011) also conclude in their study that upon issuance of new equity, accounting manipulation is a definite incentive of managers owing to the influence that accounting information has on share issue prices. Avoiding the breaching of covenant regulations laid down by financial providers also incentivises preparers to present a financial position that is neither truthful nor fair (Burgstahler et al., 2006: 987). The importance of understanding local institutions is once again highlighted in the study conducted by Holthausen (2003: 278), where he describes the incentive of many Chinese companies to report fairly bland and stable accounting figures, even during periods of extreme growth, owing to fear of their government targeting such companies for wealth expropriation.

However, the most apparent set of incentives faced by preparers arguably stems from corporate agency theory. In a pioneering publication on agency theory, Jensen and Meckling (1976, 308) discuss the phenomenon. They state that when a principal appoints an agent under circumstances where both these parties are wealth maximisers, it is conceivable that the agent will not always act in the best interests of the principal but instead may in certain instances act in his or her own best interest. Accordingly, as a wealth maximiser, the agent is inherently prone to act in his or her own best interest. This includes incentives, on the part of agents, to engage in accounting practices focused on self-enrichment at the expense of their principals (Eriksson & Tagesson, 2011: 274). This view is also held by Owens-Jackson, Robinson and Shelton (2011: 188), who state in their study that managers do indeed have incentives to manipulate accounting information focused on maximising their personal wealth.

In South Africa, the agency problem is also evident. In a study conducted by Hall (1998), a sample of JSE-listed companies was tested against a set of indicators that reflected the presence of agency challenges. Hall (1998: 159) found that in a
“substantial number of cases” the presence of agency challenges was evident. However, South Africa also has in place a number of mechanisms which create counter-incentives aimed at minimising the financial reporting element of agency challenges. As mentioned previously, it is a legal requirement for all publicly listed companies to prepare their financial statements in accordance with IFRS. In terms of the new Companies Act, any person found guilty of accounting practices that amount to fraudulent or manipulative activity faces harsh retribution in the form of a fine, a prison sentence (not exceeding ten years) or a combination of both (South Africa, 2009: 339). As a result, preparers are incentivised to engage in IFRS-compliant practices through legal influences.

Another important mechanism that aims to minimise the impact of the agency problem on the public lies in corporate governance regulations. The concept of corporate governance arose in the late 1980s in response to the developing seriousness of agency challenges (Bourne et al., 2009: 4-3). In South Africa, the King Committee on Corporate Governance was formed in 1992, aimed at delivering to the market recommendations on the effective implementation of sound corporate governance principles (Bourne et al., 2009: 4-3). This was done through the issuing of a number of reports (colloquially referred to as the King Reports), with the third and latest of these reports having been issued in September 2009. While this report does not address the issue of IFRS application directly it addresses broader issues, which also contribute to minimising the risk of financial statement manipulation. For instance, corporate ethics, risk management and auditor independence are issues on which guidance is provided to minimise the negative impact of agency problems. In a study conducted by Iatridis (2012, 101), it was found that in South Africa, these corporate governance mechanisms do indeed reduce agency costs in the market.

In addition to these regulations, all JSE-listed companies are also incentivised to engage in IFRS-compliant accounting practices, owing to the active monitoring the JSE undertakes over the financial statements of its publicly listed entities. Compliance with IFRS is also a listing requirement of the JSE and divergent accounting practices from IFRS have the potential to result in the imposition of a number of legal penalties including a legal reprimand, a fine, or payment of compensation to persons prejudiced by the divergence (South Africa, 2005: 28).
It is clear that in South Africa, accounting-based legislation and capital market regulation creates a number of incentive mechanisms for preparers to engage in responsible and IFRS-compliant accounting practice. As can be seen from the above discussion, strong mechanisms support the application of IFRS in South Africa.

4.2.1.3 Behaviour

It was established earlier that in line with institutional thinking, behaviour is believed to be influenced by the incentives that drive it (Chetty et al., 2005: 209). In essence, behaviour operates as a function of incentives. Within the context of preparing financial statements in accordance with IFRS, the previous sections discussed the kind of incentives that preparers of financial statements inherently face as a result of market forces. For instance, financial difficulty or a need for self-enrichment are factors that create environments conducive to behaviour modification on the part of preparers, and can cause them to engage in financial statement manipulation practices that they would not otherwise have considered.

In order to avoid the possibility of such behaviour materialising, a number of legal and professional regulations create counter-incentives for preparers, aimed at influencing them not to engage in such behaviour. For instance, the Companies Act and JSE regulations have the potential to impose harsh penalties for non-compliance with IFRS, which serve as incentives to motivate preparers to engage in IFRS-compliant behaviour.

4.2.1.4 Durability

Economic institutions demonstrate an element of durability in the sense that they are developed with a long term view and hence, cannot be changed easily. As mentioned previously, the requirement for publicly listed companies to prepare financial statements in accordance with IFRS is a legal one enshrined within the Companies Act. Owing to the legislative backing that this requirement currently enjoys, it is evident that this requirement holds long-term relevance. It is also evident that this requirement cannot be changed easily owing to the complex legislative processes that would need to be undertaken before legislation of this nature may be amended.
In addition, the activities of the JSE are governed by the Securities Services Act 36 of 2004. Accordingly, the activities of the JSE are also regulated through legislation.

As a result, the requirement for publicly listed companies to prepare financial statements in accordance with IFRS can indeed be considered to be durable in nature.

4.2.1.5 Constraints

In the work of Davis (2010: xv), it is simply stated that “formal institutions are endorsed by the state” while informal institutions are not. In applying this reasoning to the requirement to prepare financial statements in accordance with IFRS, it can be concluded that this is indeed a formal constraint owing to the legal backing that the requirement enjoys.

In a study conducted by North (1994: 360), a distinction was made between the constraints themselves and the enforcers of those constraints. In assessing the legal requirement to prepare financial statements in accordance with IFRS against this backdrop, it is clear that this requirement represents the constraint, while other mechanisms (to be discussed later) such as the audit of financial statements for IFRS compliance, represent the enforcement elements of this constraint.

4.2.1.6 Concluding Comments

In this section, the discussion addresses the institutional functionality of accounting practice in South Africa in relation to the first key element of accounting practice in South Africa, being the preparation of financial statements in accordance with IFRS. In applying the criteria of economic institutions established in Chapter 3 to this key element, it was established that this practice does indeed create certainty in the market owing to the requirement’s strong supportive mechanisms in the form of legal and professional regulations. It was also established that these mechanisms create incentives for IFRS-compliant behaviour in the market. Lastly, it was then ascertained that this element, being formal in nature, demonstrates the characteristic of durability owing to its influences being enshrined in legal regulation. In summary, this element
of accounting practice in South Africa indeed demonstrates the characteristics associated with economic institutions and hence, can be considered institutional in nature.

4.2.2 Key Element 2 - The Audit of Financial Statements to assess IFRS Compliance

The second key element of accounting practice in South Africa that was identified in Chapter 2 centred on the audit process conducted to evaluate the nature, timing and extent of IFRS compliance in the preparation of financial statements. In the following section, the criteria of institutions that were developed in Chapter 3 were applied to this key element to assess its functionality as an economic institution. As with the previous discussion on the first key element of accounting practice in South Africa the same approach was followed, where this key element was assessed in accordance with the criteria of certainty, incentives, behaviour, durability and constraints.

4.2.2.1 Certainty

In previous sections, it was noted that the requirement to prepare financial statements in accordance with IFRS only becomes institutional in nature when accompanied by appropriate support mechanisms to enforce and monitor the required compliance with IFRS. One such mechanism, and arguably the most notable, is the independent audit undertaken by suitably skilled auditors and audit firms whom Eriksson and Tagesson (2011: 274) describe as “important actors in the process of institutionalising accounting standards”.

The financial statement audit is seen to be a mechanism that creates confidence in the credibility of a company’s financial information. In their study, Eriksson and Tagesson (2011: 274) quote the work of Pentland (1993), who described auditing “as a ‘ritual’ that offers a sense of order and safety”. It is through this “ritual” that investor confidence is enhanced, owing to the qualities of reliability and integrity that an independent audit attaches to a company’s set of financial statements (Kueppers & Sullivan, 2010: 287; Tsui, 2009: 22). In his study, Brook (2011: 40) goes further to
state that an unqualified audit opinion in fact has reputational benefits for an organisation by enhancing public confidence and trust in the organisation.

Accordingly, an unqualified audit opinion inspires trust among stakeholders to confidently believe that the financial information being released by a company fairly reflects its financial position and performance and hence, may be relied upon as a basis for making certain economic decisions. It is through this trust and reliability, that certainty is created in the market as far as the credibility of an entity’s publicly released financial information is concerned.

In South Africa, these notions are no different when compared to international counterparts. Bourne et al. (2009: 1-3) describe within a South African context, the impact of an audit opinion on the public as being one that plays an important role in increasing the credibility of issued financial statements and hence, affords various stakeholders the ability to use these financial statements to make economic decisions. From an institutional perspective, it is clear that by virtue of the credibility that an independent audit adds to an entity’s released financial information, the role of an audit undoubtedly creates more certainty by aiding financial and economic decisions within the market.

4.2.2.2 Incentives

From the previous discussions on the element of accounting practice pertaining to the preparation of financial statements in accordance with IFRS, it was noted that the preparers of financial statements face various incentives to manipulate financial information. To remedy this, the independent audit is meant to address these incentives by creating counter-incentives which in turn serve to discourage such behaviour (Dehkordi & Makarem, 2011: 121). This is further pointed out in the work of Eriksson and Tagesson (2011: 274), who state that in the absence of an audit, “there is an increased risk that the agent will abuse the information advantages and power of trust in order to profit at the expense of the principals and other stakeholders”.

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The independent audit is also believed to create incentives among management to improve upon their financial reporting by serving as somewhat of a “forcing function”, where management consciously implements improvements to their financial management affairs in anticipation of their annual audit (Brook, 2011: 40). This view is also held by Kueppers and Sullivan (2010: 288) who state that by virtue of the external audit being part of the financial reporting process, this “often engenders more care on the part of management”.

Apart from the incentives that face management, of equal importance are the number of other incentives that influence the manner in which the independent auditor carries out its own duty to objectively express an opinion on an entity’s financial statements. In instances where these incentives are not effectively addressed by suitable regulation and legislation, the audit process is undermined, thereby impairing the entire financial reporting process (Dehkordi & Makarem, 2011; Francis & Wang, 2008: 185). For instance, an important factor that influences the ability of the auditor to carry out its duties impartially and responsibly lies in the extent to which the auditor relies on its clients audit fees. In their study, Francis and Wang (2008: 157) noted that in the absence of the right incentives “auditors may go along with earnings management behaviour and the reporting of low quality earnings in order to avoid dismissal by clients”. In agreement with this view, Eriksson and Tagesson (2011: 275) refer to the work of Antle (1982) when stating that “unless auditors are supposed to act differently compared to other agents, it could be assumed that auditors will act in order to maximise their own wealth and utility”.

As in other countries, these incentives are applicable to South African auditors as well. In South Africa, these incentives do not remain unaddressed. As discussed in Chapter 2, a number of key pieces of legislation, enforceable in conjunction with internationally recognised professional standards, impose stringent laws and regulations on the audit profession in South Africa. For instance, an auditor’s duty to act responsibly is governed by various forms of legislation.

In their book, Bourne et al. (2009: 6-13) state that an auditor may be legally prosecuted and liable to its client should it be proved that the audit was not carried out properly, and in accordance with ISA standards. They further state that an auditor
could be found to be legally liable to third parties as well, in the event of an improperly conducted audit, owing to common law provisions that currently exist in South African legislation. In addition, they state that if an auditor is found guilty of engaging in falsification or fraudulent activities, criminal liability may result owing to the provisions laid down in the new Companies Act and the APA. Accordingly, South African law lays down stringent penalties for auditor negligence or misconduct that serve as counter-incentives aimed at influencing auditors to refrain from such activity.

Over the years these laws and regulations have created a robust and well-respected audit profession in South Africa, evidenced by the “strength of auditing and reporting standards within South Africa” being ranked number one in the world by the World Economic Forum for three consecutive years to date (World Economic Forum, 2010: 303; World Economic Forum, 2011: 323; World Economic Forum, 2012: 325).

In summary, it is important to note that both management and auditors are naturally incentivised to act in their best interests and that such behaviour does not always result in responsible and truthful financial reporting. In response to these incentives, counter-incentives are created by legislation and professional regulations which, as the discussion above indicates, indeed serve to modify the behaviour of these role players to refrain from engaging in such practices.

4.2.2.3 Behaviour

It was established earlier that behaviour is believed to be driven by incentives. Within the context of this element of accounting practice, being the audit of financial statements for IFRS compliance, it was noted in the previous section that auditors inherently face a number of incentives to engage in practices focused on the maximisation of their own wealth. For instance, auditors are incentivised to overlook certain irregularities within clients’ financial statements in instances where they rely on the clients audit fee. In other instances, auditors are also incentivised to accept earnings management practices conducted by their clients in order to avoid confrontation and potential dismissal.
In response to these behavioural incentives, South African legislation lays down a number of stringent regulations that aim to influence the behaviour of auditors to engage in responsible and ethical audit practice.

**4.2.2.4 Durability**

As discussed in Chapter 2, the audit profession in South Africa is governed by a number of legislative and professional regulations. From the auditor's perspective, all provisions relating to the governance of the profession are contained within the new Companies Act together with the Auditing Professions Act. As with the first key element, the audit of financial statements to assess IFRS compliance is governed by legal provisions that cannot be changed easily owing to the stringent legislative processes that are involved in enacting, amending or repealing legislation in South Africa. Accordingly, the requirement to audit financial statements to assess IFRS compliance is long-term-focused, and hence, durable in nature.

**4.2.2.5 Constraints**

Institutions endorsed by the state are considered to be formal in nature. Owing to the behavioural incentives auditors face through legislative constraints in South Africa, the nature of the institutional mechanism governing audit practice in South Africa can be considered formal in nature. In addition, the audit process can also be seen to be an enforcement mechanism which monitors the legal requirement for all public companies in South Africa to implement IFRS in the preparation and presentation of their financial statements.

**4.2.2.6 Concluding Comments**

In this section, the institutional functionality of the independent financial statement audit was assessed. It was established that the independent audit creates certainty in the market by providing a sense of reliability to interested parties in the credibility of an entity’s released financial statements. It was also stated that in light of the inherent incentives faced by auditors to overlook management irregularities in certain instances, a host of professional and legal regulations modifies audit behaviour in
line with abstinence from such practices. Lastly, it was stated that owing to such regulation being enshrined through professional and legal backing, the audit function is both formal and durable in nature. In light of these discussions, the audit of financial statements to assess IFRS compliance does indeed demonstrate institutional characteristics and hence, may be considered to be institutional in nature.

4.3 CONCLUSION

This chapter set out to conclude on whether or not accounting practice in South Africa can be considered to be an economic institution by applying the criteria of institutions (described in Chapter 3) to the key elements of accounting practice (described in Chapter 2). These discussions were then provided in two sections. The first section addressed the first key element, being the preparation of financial statements in accordance with IFRS, while the second section addressed the second key element, being the audit of financial statements to assess IFRS compliance.

The discussion on Key Element 1 revealed that the preparation of financial statements in accordance with IFRS does indeed exhibit institutional characteristics. Owing to the level of transparency and quality that IFRS-based financial information demonstrates, in conjunction with its ability to facilitate comparability across markets, such information creates greater certainty among users of such information. Preparers of IFRS-based information also face certain incentives from various avenues to engage in behaviours centred on achieving pre-determined outcomes. It was then ascertained that within a South African context, the professional and legal regulations that enforce the implementation of IFRS create counter-incentives that result in behaviour centred on preparing financial information in accordance with IFRS, resulting in the delivery of high-quality and reliable financial information to the public.

The discussion on Key Element 2 also revealed that the audit of financial statements to assess IFRS compliance equally demonstrates institutional characteristics. It was ascertained that the independent audit attaches the qualities of reliability and credibility to public financial information and in so doing creates a sense of trust and
confidence in the way stakeholders view such information. Accordingly, certainty is created in the market where such information is widely regarded as being a suitable and appropriate source on which to base economic decision-making. It was also stated that auditors themselves have incentives to engage in behaviour that maximises their own wealth, even though these behaviours may be counter-productive in assuring the reliability of the financial information that they are meant to audit in a neutral and objective way. To counter these incentives, however, there are also a number of other legal and professional regulations that create counter-incentives for auditors to engage in behaviours that are independent, responsible and free from bias.

The two key elements of accounting practice both demonstrate strong institutional characteristics. By combining these elements and considering them as a whole, it can therefore be concluded that accounting practice in South Africa does indeed function as an economic institution.
CHAPTER 5

CONCLUSION

5.1 INTRODUCTION

As explained in Chapter 1, the study sought to answer the question of whether or not accounting practice in South Africa operates as an economic institution. In answering this question, the study followed a three-step, qualitative approach of an exploratory nature. The first step, addressed in Chapter 2, delineated accounting practice in South Africa by providing a discussion on the identity and role of its major role players. This discussion then served as a platform in further identifying the key elements of accounting practice in South Africa. The second step, addressed in Chapter 3, developed a set of criteria which is generally agreed among institutional economists to be present in most functioning economic institutions. The third and final step was addressed in Chapter 4, where the criteria of economic institutions (developed in Chapter 3) was applied against the key elements of accounting practice in South Africa (identified in Chapter 2). Consequently, the chapter answered the research question by providing a discussion on the institutional functionality of accounting practice in South Africa.

5.2 STUDY OBJECTIVES

The study began by stating that currently, there is no comprehensive basis of theory for the practice of accounting, which has created uncertainty within the profession both among practitioners and academics alike. Some of the most conspicuous features of this uncertainty were then discussed. The first of these was described as the uncertainty surrounding the academic status of accounting. The second element of uncertainty discussed centred on the professional status of accounting, while the third feature focused on the uncertainties created owing to certain developments within practice.

These discussions then led to the introduction of the research problem, being that there currently exists no comprehensive, academically-sound theoretical basis on
which to develop rules, principles and frameworks for the practice of accounting that are able to serve the public interest. In addressing this problem, the study then made reference to a body of literature proposing institutional thinking as a viable basis for the development of this theory. In light of this, it was established that the objective of the study would be to assess if indeed accounting practice does function as an economic institution, in order to provide further academic merit to the proposal of utilising institutional thinking as a basis for the development of accounting theory.

The research question was thus whether or not accounting practice in South Africa does indeed function as an economic institution. The chapter then discussed the three-step approach that would be followed in the remainder of the study in order to answer the research question. The first step, the discussion of accounting practice in South Africa, was addressed in Chapter 2 where a holistic overview of the identity, functions and interdependencies of the major role players within the accounting profession was provided. The second step, addressed in Chapter 3, entailed the establishment of a generally agreed upon set of characteristics believed by institutional economists to be present in most functioning economic institutions. The third and final step was then addressed in Chapter 4, where the practice of accounting in South Africa was assessed in relation to the criteria set out in Chapter 3. It was concluded that accounting practice in South Africa does indeed function as an economic institution.

5.3 REVIEW OF ACCOUNTING PRACTICE IN SOUTH AFRICA

Chapter 2 centred on discussing the concept of “accounting practice in South Africa” and in so doing firstly identified all the major role players that contribute to the practice of accounting and secondly, described each of their functions. From this discussion, two key elements of accounting practice were then extracted. The first of these was described as being the preparation of financial statements in accordance with IFRS, and the second was described as the audit of financial statements to evaluate their IFRS compliance. Owing to the involvement of all the major role players in their effective functioning, these key elements were assessed as being holistic, all-encompassing features of the practice of accounting. Accordingly, these
elements were considered to be appropriate bases against which the criteria of institutions (developed in Chapter 3) could be applied.

5.4 THE CHARACTERISTICS OF ECONOMIC INSTITUTIONS

The second step was then addressed in Chapter 3, where a discussion on institutional economic theory was provided. This discussion developed a generally agreed upon set of criteria which institutional economists agree is present in most economic institutions.

The first of these centred on the concept of behavioural influence where it was established that institutions influence the economic behaviour of those who are exposed to them. The second criterion discussed, closely linked to the first, stated that institutions create one or more incentives as a means to influence that economic behaviour. The concept of uncertainty was then addressed as the third criterion, which stated that institutions assist in decreasing the uncertainty that is associated with human interaction. Fourthly, the criterion of durability was then discussed where it was stated that institutions demonstrate permanence in the sense that they do not change easily or frequently. Lastly, the concept of constraints was then discussed, and it was stated that institutions establish or enforce constraints through either formal or informal means.

In Chapter 4, these criteria were then applied to the key elements of accounting practice which were developed in Chapter 2.

5.5 ACCOUNTING PRACTICE IN SOUTH AFRICA AS AN ECONOMIC INSTITUTION

Step three was addressed in Chapter 4, where the criteria of economic institutions developed in Chapter 3 were applied to the key elements of accounting practice established in Chapter 2.

The criteria of economic institutions were firstly applied to Key Element 1, being the preparation of financial statements in accordance with IFRS. Under the criterion of
certainty, it was found that, firstly, such information plays an important role in
reducing uncertainty for preparers by assisting them in maintaining high quality
accounting records which in turn allow them to exercise better control over their
financial affairs. In addition, it was also found that the preparation of financial
statements in accordance with IFRS results in the provision of high-quality financial
information to the market, which assists market participants in making better
economic decisions, thereby reducing their uncertainty towards the financial health of
a particular company.

With regard to the criteria of behavioural influence and their related incentives, it was
noted that preparers face a number of incentives to engage in misrepresentative
accounting practices. However, the legal and professional mechanisms that enforce
the application of IFRS in the preparation of financial statements challenge these
incentives by creating counter-incentives which influence preparers to engage in
ethical accounting practices in the form of appropriately utilising IFRS in the
preparation of their financial statements. Accordingly, the legal and professional
regulations that require preparers to utilise IFRS in the preparation of their financial
statements does indeed create incentives that modify their behaviour towards doing
so.

Lastly, on the criteria of durability and constraints, it was noted that given the legality
associated with the requirement (and hence constraint) to prepare financial
statements in accordance with IFRS, a sense of formal durability enshrines the
requirement owing to the robust legislative processes that exist in South Africa.

The second key element of accounting practice in South Africa, being the audit of
financial statements to assess their IFRS compliance, was then addressed in relation
to the criteria from Chapter 3.

The first criterion discussed was that of certainty where it was found that the audit of
financial statements creates within the market, a sense of trust and confidence in the
information contained within a set of financial statements. Accordingly, an
independent audit attaches the qualities of credibility and reliability to a set of
financial statements, thereby creating certainty among users that such information may be used as a basis upon which to formulate economic decisions.

The discussion then went on to address the criteria of behavioural influences and their related incentives. It was established that in relation to the incentives faced by management to engage in misrepresentative accounting practices, the independent audit creates counter-incentives by serving a “policing” function where IFRS compliance and hence responsible and representative accounting practice, is ensured. It was also noted that the independent audit was also effective in influencing behaviour centred on improved financial management efficiencies. From the perspective of the auditors themselves, it was noted that they too face incentives centred on maximising their own wealth. To counter these incentives, a number of legal and professional regulations exist, aimed at maintaining the credibility and objectivity of audit practice in South Africa.

In relation to the second key element of accounting practice, the criteria of durability and constraints mimicked the discussions from the first key element of accounting practice. Through legal constraints governing the audit profession, a sense of formal durability also enshrines the audit of financial statements.

In essence, it was found that the accounting practice in South Africa does indeed function as an economic institution. Accordingly, the exploration of developing accounting theory from this perspective, prima facie, appears to be a promising endeavour.

5.6 FUTURE RESEARCH

An important objective of this research was to introduce institutional thinking as a viable foundation for accounting research to the academic community in South Africa. Accordingly, this research lays a promising foundation for future research into this area of enquiry. Specific examples of the kind of research that could be undertaken in the future are discussed below.
In Chapter 1, it was noted that properly conducted research into exploring the identity and information needs of users of financial statements was absent. Efforts in performing research into this area may be undertaken in the future.

In Chapter 2, a number of role players were identified and their functions within the practice of accounting were discussed. Future research in this area could entail exploring the institutional role of each of those role players in far greater detail.

Given the sophisticated structures that govern the practice of accounting in South Africa, research into developing an institutional model for the effective functioning of IFRS may be developed.

As far as could be established, an assessment of this nature has not been conducted within any other country. Accordingly, a study of this nature may be extended to other countries as well.

In light of the development of integrated reporting as a new area of accounting practice, a study similar to this one, may be conducted for integrated reporting practice in South Africa.

Finally, research into developing a framework of theory for the practice of accounting may be conducted, using institutional economic theory as a basis. In using incentives as a basis for behaviour modification, this basis of thinking may be utilised in the development of accounting rules and principles. This would entail developing a publicly beneficial framework of behaviour which regulators would ideally wish to see in the practice of accounting, and subsequently developing rules and principles focused on influencing behaviour in the market in conformity with those behavioural objectives.
REFERENCE LIST


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