Financial Crisis, Firms, Reporting Entities, and the Going Concern Assumption

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FINANCIAL CRISIS, FIRMS, REPORTING ENTITIES, AND THE GOING CONCERN ASSUMPTION

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ABSTRACT

Orthodox academic and accounting standard setting literature has historically viewed accounting reporting entities as independent units with an indefinite life. The 1929 and 2008 financial crises are used as focal points for a critical evaluation of the theory of a firm, the reporting entity concept, and the going concern assumption. Alternative perspectives from organizational theory, physics, and non-Western philosophical traditions suggest that firms and markets are best conceptualized not as separate static units, but as a dynamic and intricately entangled matrix of relationships. This paper argues that a Western cultural bias, philosophical pragmatism, and Aristotelian logic implicit in dominant accounting conceptual frameworks have all worked to downplay normative public interest issues that are essential to an understanding of the functioning of economic enterprise in a dynamic global society.

Keywords: Firms; financial crisis; reporting entities; going concern; philosophical pragmatism; quantum physics; culture; public interest

I. INTRODUCTION

Accounting for corporate entities is central to financial accounting standard setting projects. This paper argues that dominant accounting conceptual frameworks view firms through a conventional lens. Firm boundaries are treated as obvious, needing no theoretical justification. While neoclassical economic theory of the firm (Coase 1937) is widely used to support dominant financial markets research in the academy, emerging literature raises questions about how this model distinguishes between markets and firms. FASB and IASB conceptual frameworks paint accounting entities as self-evident, objectively determinable independent units presumed to have an indefinite life. Yet practical disagreements on how to account for goodwill, leases, and variable purpose entities suggest the dividing line between entities is not at all self-evident.

Bourdieu and Passeron (1977) argue that taken-for-granted values support the interests of dominant, powerful players in society. The American model of financial accounting as an activity informed by conceptual frameworks and codified standards began largely as a response to the financial market crash of 1929. A similar model has been adopted by the International Accounting Standards Board (IASB), thereby impacting the global market place. This paper argues that current accounting rules and institutional structures that have evolved since the 1930s embody implicit models of reality that often go unquestioned, remaining intact even as the dynamics of practice and society move in new directions. Firms are conventionally depicted as unitary, independent entities whose financial health can be readily assessed from accounting data. The societal fallout when those assumptions do not hold is highlighted by the character of the 2008 financial crisis. Large numbers of firms with seemingly healthy balance sheets not only failed, but more importantly their interlocking contracts threatened the viability of the financial market matrix and its associated regulatory structures worldwide. This paper suggests that the 1929 and 2008 financial crises can be used as focal points for reflection on the nature of economic reality and how it is depicted in financial reports.

This paper begins with an overview of the crash of 1929 and the sub-prime crisis of 2008. This is followed by a review of emerging literature that challenges the conventional treatment of a ‘firm’ as an independent unit of analysis. The paper will consider the development of the accounting entity concept in Western accounting standard setting literature. The historical section suggests that Western conceptual frameworks have been heavily influenced by philosophical pragmatism which embodies an approach to knowledge that promotes the appearance of neutral, objective decision making devoid of normative goals. The paper will argue that the FASB/IASB depiction of entities is markedly in contrast to alternative philosophical foundations that view all phenomenal entities as dynamic
structures enmeshed in a web of relationships. The paper concludes that traditional economic and accounting models do not adequately represent the entangled nature of firms and markets.

II. ELEMENTS IN FINANCIAL CRISIS -- 1929 AND 2008

The accounting and economics disciplines arguably derive their professional status at least in part from society's search for answers on how to control firms and markets. Economic cycles of boom and bust have recur with some regularity throughout recorded history. This paper defines a financial crisis as an event that has a sudden catastrophic impact on market prices, causes widespread loss of confidence in financial institutions, and has effects that linger for an extended period of time. Events in 1929 and 2008 meet this characterization, having been labelled as the two worst financial crises to occur in peace time (Worstell 2014).

The Great Depression's catastrophic drop in prices began Thursday October 24, 1929, with panic setting in by Monday and Tuesday of the following week. The Dow index of 381 on September 3, 1929 had fallen to 199 by November 13, 1929. Markets recovered to 294 by April 1930, but fell to 14 on July 8, 1932. The stock market crash triggered bank 'runs' and spread to markets around the globe. Markets did not recover to the level of the 1929 peak until 1954.1 Mandatory auditing of publicly traded firms, formal accounting standard setting process, deposit insurance, and mandatory levels of capitalization for banks all came into play as a response to the 1929 crisis.

Financial institutions were generally tightly regulated from 1940 to 1980 (Eichengreen 2015, Hake 2005). By 1980 rigid caps on interest rates that were out of step with the high inflation of the period contributed to a number of savings and loan failures. In this climate, the financial sector consolidated into a few giant firms and took advantage of the climate of the times to push for de-regulation of the industry under the presidents from both major political parties with the SEC relaxing its net capital rule in 2004.2 As risky derivatives became popular in the 1990s, financial institutions were successful in blocking derivative regulation in the Commodity Futures Modernization Act of 2000. By the early 2000s, the industry was dominated by five investment banks (Goldman Sachs, Morgan Stanley, Leman Brothers, Merrill Lynch, and Bear Stearns), two financial conglomerates (Citigroup and JPMorgan Chase), three securitized insurance companies (AIG, MBIA, and AMBAC) and three rating agencies (Moody's, Standard & Poor's, and Fitch). The financial firms bundled together mortgages and other instruments into collateralized debt obligations (CDOs) which were made up of subprime loans, but were nevertheless quite commonly rated investment grade in quality. To support the CDO instruments, the industry also developed credit default swaps (CDSs) that allowed investors to bet against CDOs they did not own. Banks that had issued CDOs often bought CDSs to bet against the possible collapse of their own portfolios as the percentage of 'subprime' mortgages increased to nearly 20% of the market (Ferguson 2010).

Home prices grew steadily from 2000 to early 2006, but price drops later in 2006 led to an increase in foreclosures. The FDIC put Indy Mac into conservatorship after it experienced a liquidity crisis and bank 'run' in July 2008. Withdrawals from money market funds then impacted the commercial paper used by corporations to fund operations and payrolls. A cash crisis at Bear Stearns in early 2008 caused it to be taken over by JPMorgan. In September 2008 the federal government took over Fannie Mae and Freddie Mac. Merrill Lynch was acquired by Bank of America, but Lehman Brothers was forced into a bankruptcy that threatened the entire global financial system. Unemployment rose to 10% in the US and European Union. Homelessness, loss in the value of homes and savings, massive downsizing in Asian factories and the bankruptcies of GM and Chrysler are other side effects of the crisis. Tripp (2015) estimates the impact of the 2008 crisis as 5% of global Gross Domestic Product, $7.5 Trillion, or $1,100 USD for every man, woman, and child on the planet.

For purposes of this paper, two characteristics of the 2008 crisis are most salient. Number one, weaknesses in the system were not widely apparent from the financial statements or the associated security ratings and very few economists predicted the implosion (Tamny 2013). Second, perhaps even more clearly than the crash of 1929, the 2008 crisis illustrates the impact of the relationships and connections between firms. This is the aspect that will be explored further in the next two sections of the paper that look at how firms are conceptualized in economic theory and in accounting conceptual frameworks.

III. THEORY OF THE FIRM

1 http://www.macrotrends.net/1319/dow-jones-100-year-historical-chart

The dominant theory of the firm in the academy commonly references Coase (1937). With the renewed interest in this literature reflected by Jensen and Meckling (1976), Cheung (1983), and Watts and Zimmerman (1990) agency theory came to be widely used as a model of tradeoffs between self-interested behaviors that could channel corporate resources to private ends and the costs of monitoring formal and informal contracts. Coase (1937) argued that firms exist because there are cost efficiencies when internal actors choose to operate with informal rather than formal monitoring of contracts.

Addleson (2001) and later Santos and Eisenhardt (2005) provide compelling critiques of agency theory cost efficiency arguments. Addleson (2001) argues the transaction based model treats contracts as a ‘bloodless’ creation. The psychological process of management decision making is ignored in an impersonal calculus of risks and rewards where agents and principals weigh and adjust for the inherently self-interested behaviors of their respective counterparty in a contract. Built on a neo-classical model of economics that assumes markets adjust quickly to an equilibrium state, Addleson argues that the traditional economics of finance model of a firm has had little or no influence outside economic or financial research (2001, p. 169). While organizational disciplines arguably should be interested in economic theory of firms, this is belied by Boettiger’s (1967, p. 56) observation that human resource and management experts do not use these economic models because technical innovation would be beside the point in a system where markets always devolve back to an equilibrium where all firms earn virtually the same return. Addleson (2001, p. 170) concludes that the traditional narrative of the firm is based on a positivist empirical model where firms are treated as a plastic cog in a mechanical Erector-Set of self-evident, bounded objects that can be readily observed and manipulated to achieve desired goals.

An alternative view of firms is emerging that sees business institutions and the relationships between actors and institutions as the more relevant units of analysis. A study by the Institute of Chartered Accountants in England and Wales (ICAEW 2010) point out that the definition of a firm as a ‘nexus of contracts’ in traditional agency theory per Jensen and Meckling (1976), Cheung (1983), or Watts and Zimmerman (1990) makes it impossible to draw a hard line between what is inside and what is outside the boundaries of any given organization. Though firms and markets are widely used as research constructs, Williamson [1983] maintains there is no clear distinction or dividing line between the two constructs. This is especially true for firms large enough to influence market prices.

Addleson (2001) suggests that there are two alternatives to the agency theory approach to firms. One is to focus on institutions as an enduring mechanism for structuring activities. He argues that while knowing how institutions work can help people make their way in life, the downside to this approach is that institutional structures can be interpreted by various parties in divergent ways. A second model was proposed as early as 1949. Mises (1949) noted that “the market is not a place, a thing, or a collective entity. The market is a process” (p. 258). Addleson (2001) concludes that while it may still be worthwhile to measure institutional market share for certain conventional purposes, the process model is theoretically superior by virtue of its recognizing and emphasizing the dynamic nature of boundaries in firms and markets alike.

Santos and Eisenhardt (2005) identify 1) efficiency/cost, 2) power/autonomy, 3) competence/growth, and 4) identity/coherence as fundamental issues that are addressed through boundary setting. The efficiency/cost dimension aligns most closely with traditional transaction cost models of the firm which assume that legal boundaries should be set in such a way as to minimize the governance costs of monitoring. Santos and Eisenhardt conclude that the efficiency model “implicitly assumes an established structure of economic activity ... [and therefore] is most applicable in industries characterized by intense price competition and stable structure” (p. 493). They argue that the power dimension hypothetically could be used to reduce uncertainty by internalizing sources of environmental uncertainty (p. 495) and would be particularly useful for oligopolies and regulated environments (p. 497). While they did not address this issue specifically, their work would seem to imply that if regulated financial institutions are protected from market failure by government guarantees then the power dimension could also be associated with the willingness to pursue high risk, high return transactions such as the credit default swaps seen in the 2008 Crisis.

The overall conclusion of Santos and Eisenhardt’s (2005) paper is that boundaries are dynamic, permeable, and can only be understood holistically (p. 502). They see their work as laying the groundwork for renewed interest in ‘normative evidence’ (p. 504). Other academics argue that models from philosophy, quantum physics, or organic biology might be used as alternatives to the economics transactions cost model (Korten 2000, Wheatley 2006, Wann 2010). They see these models as better able to address the unpredictable in chaotic open systems. In a similar vein, Hirschhorn and Gilmore (1992) and Ashkenas, Ulrich, Jick and Kerr’s (2002) work focuses on helping organizations assess and correct dysfunctional boundaries in a new “boundaryless” operating model.
IV. ACCOUNTING ENTITIES AS INDEPENDENT GOING CONCERNS

Rule-based accounting standard setting projects evolved as a post-Great Depression means of strengthening confidence in financial markets. Dr. Scott's (1931) classic work *The Cultural Significance of Accounts* reflects on some of the major economic and social trends affecting accounting practice in that era. The late nineteenth and early twentieth century represented a period of great change in social structure, industrial organization, and academic thought. With religious institutions declining in prominence as centers of intellectual inquiry, Scott and many other prominent thinkers of the day had begun to adopt Darwin's (1859) concept of biological evolution to social and institutional studies. Scott maintained that the primary worldviews inherent in accounting practice and organizational management were individualism and managed impressions of scientific objectivity.

Scott (1931) felt that the concept of individualism was fundamental to the early development of double entry accounting even as he argued that individualism was already becoming increasingly outdated in an economy dominated by large stock-based corporations. Scott maintained that accounting rules and practice had developed without any specific theoretical basis, but were effective because they could serve the function of a philosophy of law in managing the appearance of a rational cultural structure (p. 180). According to Scott, conceptualizing corporations as fictitious ‘persons’ was being adhered to out of an inherently conservative tendency within established professions and institutions.

Accounting historians argue that accounting standard setting has been strongly influenced by philosophical pragmatism (Enke 1972, Doupch 1962, Rutherford 2013 and 2016, Lleltron 2016). This system was developed by Charles Sanders Peirce (life dates 1839-1914), William James (1842-1910), and John Dewey (1859-1952) as an outgrowth of Charles Darwin (1809-1882) promotion of a then revolutionary theory of biological evolution. Prior to Darwin, religious constructs or ideals of the Ultimate Good were often used as the basis for theories about the nature of the cosmos and everything in it. The pragmatists argued that objective science could be used to reach conclusions about material and social phenomena without having to rely on or make any assumptions about ‘God’, transcendental reality, or the normative goals of society. While Scott (1931) saw accounting as closely aligned with the legal field, even as early as 1905 Starrett argued that accountants could elevate their status by adopting a science mindset modelled after the medical and engineering professions.

As accountants began to write accounting standards and theory after the Great Depression they were faced with implicit questions of ontology as they struggled with essentially creating a map of reality that could be adequately reflected in accounting reporting units and classifications. Questions of philosophic or scientific ontology can be attacked either by developing an inventory of the aspects of reality being addressed, or by searching for fundamental postulates or axioms, i.e., agreed upon assumptions that can be used for logical analysis (Moravcisk 1992). The accounting profession tried both, beginning with descriptive statements before switching to a deductive system which was never formally adopted, but led to a compromise system that underlies the current FASB and IASB conceptual frameworks.

Zeff (1999, pp. 91-92) depicts 1940s contributions to accounting theory as primarily descriptive. During the 1950s, Accounting Principles Board (APB) committees worked to develop a deductive system built on postulates, axioms, and principles of accounting presentation which were set forth in *Accounting Research Study (ARS)* No. 1 (Muozit 1961) and ARS No. 3 (Sprouse and Moonitz 1962). ARS No. 1's environmental postulate on entities noted that “Economic activities are carried on through specific units or entities. Any report on the activity must identify clearly the particular unit or entity involved” (p. 52). ARS No. 1 depicted reporting units as separate units, but allowed for flexibility in reporting off entity boundaries. The postulate system was never implemented in practice because the deductive reasoning in ARS No. 3 would have promoted departures from historical cost that were considered too radical at the time. In his critique of the postulate statements Arnett (1967) held that “accounting theory ... should be based on the scientific, or objective, point of view” (p. 292). In contrast, Patillo (1965, pp. 60-61) argued a normative goal like fairness should be the singular underlying postulate. Scott (1941, pp. 342-343) argued for truth, justice, and fairness.

Accounting Principles Board Statement (APBS) No. 4 (AICPA 1970) continued to allow for flexible boundaries, describing entities as “... circumscribed areas of interest [whose] boundaries ... may not be the same as for the legal entity ...” (p. 44). Reporting entity boundaries in early standard setting work were treated as either obvious or a matter of practical judgment. The current FASB and IASB conceptual frameworks are still in the process of formulating an official position on the meaning of the entity concept. To that end, a chapter in Concept Statement No. 8 is reserved for treatment of entity issues. The 2010 joint FASB/IASB exposure draft defined a reporting entity as (p. 1):
a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders, and other creditors who cannot directly obtain the information they need in making decisions.

In describing how the boundaries of a reporting entity were to be determined, the draft listed three very broad criteria (pp. 1-2):

1) Economic activities are being conducted, have been conducted, or will be conducted,
2) Those economic activities can be objectively distinguished [emphasis added] from those of other entities and from the economic environment in which the entity exists, and
3) Financial information ... has the potential to be useful in making decisions.

Some respondents to the exposure draft noted that the practical mechanics and theoretical foundations of how to objectively determine those boundaries were a glaring omission; others pointed out that reporting entities are often prescribed by nation specific regulations (FASB Online Comment Letters 2010, especially Nos. 69, 86, 99, and 102). By 2013 the IASB’s exposure draft for its revised conceptual framework had reworked the reporting entity definition to “an entity that chooses, or is required, to prepare general purpose financial statements” (IASB 2015, p. 35). The boundaries of the reporting entity should (IASB 2015, p. 35)

a) provide the relevant financial information needed by those existing and potential investors, lenders and other creditors who rely on the financial statements; and
b) faithfully represent the economic activities of the entity.

In effect, the exposure draft seems to say financial statement preparers should do whatever is required by law or expedience, ultimately providing no real theoretical guidelines at all.

The going concern assumption, like the entity concept, has been treated as a given in spite of the inherently risky nature of business enterprise. The reporting entity paints businesses as objective independent units; the going concern presumption arguably lends firms an impression of permanence. Hahn (2011) traces the first recorded use of the term going concern value to a 1620 legal decision. Hahn demonstrates that the going concern assumption appeared in major accounting handbooks and textbooks in the early twentieth century before it was codified as part of Accounting Research Bulletin No. 43(Committee on Accounting Procedure 1953). The concept was later proposed as a basic postulate in ARS No. 1 in 1961.

It is particularly noteworthy that Sterling (2001) claims that “[t]he ‘going concern’ is the accountant’s ‘firm model’” (p. 481); widely accepted, but never clearly defined. He argues that the going concern model implicitly assumes a ‘stationary state’ in which the firm will “continue in much the same manner as in the past” (p. 489). Fremgen (1968) concludes the going concern assumption has been one of “the most firmly entrenched and least controversial” (p. 649) ideas in accounting. Rubin’s (1984) created a graphic for a ‘house of GAAP’ which depicts the going concern concept as a foundation that implicitly supports detailed accounting standards. Occasional detractors like Arthur Anderson & Co. (1960), Sterling (1968), and Storey (1959) argue that the going concern concept is inconsistent with business reality and is not really needed to support accounting measurement or realization decisions.

New standards for assessing the likelihood of a firm continuing as a going concern were put in place after the 2008 crisis. These standards address management and auditor responsibilities for assessing the likelihood that an auditee will be able to continue to operate as a going concern for at least 12 more months. Unfortunately, the new guidelines raise as many questions as they answer (Holzmann and Hunter 2015, Edmonds, Leece, and Penner 2016, Daugherty, Dee, Dickins, and Higgs 2016). Management is now required to take the lead in providing going concern evidence. This inherently involves assessments of future cash flows which pose a moral hazard; management’s self-interested status could almost certainly be expected to influence the estimates. DeLaurell and Barbage (2014) recognize that the requirements are likely to diminish a governing board’s candor with auditors. Eickemeyer and Love (2016) argue that quarterly and annual assessment of going concern issues are so rapidly outdated as to provide little useful information anyway. Eickemeyer and Love (2016), Fischer, Marsh, and Brown (2016), and Daughtery, Dee, Dickins, and Higgs (2016) all note the potential for disclosure of going concern issues to become a self-fulfilling prophecy. These issues all support the emerging narrative that firms are not independent, standalone entities. They also belie the simplistic version of scientific objectivity promoted by philosophical pragmatism because accounting representations not only measure, but can also be used to destroy or maintain a firm’s economic reality. Viewing firms as part of an overall social matrix highlights inherent ethical issues of fair play and equitable
sharing of rewards in contrast to conventional conceptualization of firm boundaries as neutral, obvious, and objective.

V. ALTERNATIVE PHILOSOPHICAL FOUNDATIONS

The boundary lines of entities and elements within dominant financial accounting frameworks are built on conventional perspectives that assume nature conforms to the principles of Aristotelian categorical logic (Stanford Encyclopedia 2015). Aristotle's system claimed the world could be sorted into non-overlapping, mutually exclusive, disjoint 'natural kinds'. (Khalidi 1993). However, modern taxonomers often find that the physical world sometimes refuses to fit neatly into disjoint, mutually exclusive units. Purely Aristotelian taxonomies disallow dual classification except as a sub-genus. Convertible debt, stock warrants, and derivatives like the credit default swaps that played a role in the 2008 financial crisis cannot be readily sorted into disjoint, non-overlapping categories.

The accounting standard setting project that was put in play in the aftermath of the 1929 financial crisis was intended to help bolster public confidence in financial institutions and even the government itself. Porter (1992) argues that the accounting profession seeks to bolster public confidence in its work by portraying financial statements as objective, neutral quantifications. This image is supported by an institutional structure that must appear to be built on a foundation of logical rules and entities, even if some of the fundamental principles have been put in place with very little thought as to how conventional constructs may disadvantage some parties in the financial market matrix. This paper argues that, contrary to conventional treatment, entities are not inherently self-evident with objectively determinable boundaries. The categorical indeterminacy of financial entities, problems classifying hybrid financial securities like the credit default swaps, and the unstable ties between highly leveraged large firms and the wider markets all raise significant questions about the adequacy of modern financial reporting and regulatory models.

With its foundations in philosophical pragmatism, the modern academy presupposes disciplinary separations between philosophy and science and exhibits a post-Darwinian disdain for either metaphysical or normative reasoning in academic discourse. Earlier scientists like Descartes and Pascal made no such distinction. Descartes (1596-1650 CE) saw the "different parts in Science being parts of one identical spiritual organism ... with no ... distinction between Metaphysics, Mathematics, and the knowledge of Nature" (Mardian 1944, p. 48). Pascal (1623-1662 CE) claimed that there could be no certainty of axioms without connection to the transcendent (Pascal 2001). References to 'God' and the transcendent in this seventeenth century work seem out of place in the modern academy. However, there has been a tacit side effect associated with post-Darwinian philosophical pragmatism's rooting out of religious ideals. In a climate of positivist empiricism, academics are also reluctant to discuss even those normative goals and ideals that have little to do with religion, such as social justice and equitable distribution of rewards across a broad spectrum of society. The accounting profession still uses the rhetoric of public service, but its practices and conceptual frameworks are most closely aligned with upholding the rights and rewards of paying clients, investors, and creditors.

Hamid, Craig, and Clarke (1993) argue that non-Western philosophical perspectives might be a source of innovative approaches in problem areas in accounting practice including the lack of a broad public interest perspective. Baydoun and Willett (2000, p. 73) emphasize that the dominant religion in a region influences secular behavioral norms and administrative law even for those who are not members of the majority sect. For example, secular administrative statutes in Islamic societies may require a specified level of charitable giving from all businesses as modelled on collectivist responsibilities inherent in Islamic literature.

Many Eastern philosophies have historically emphasized the difference between conventional perceptions of self-evident diversity and a transcendent truth, unity, or oneness across society. In Buddhist philosophy, all phenomena are seen as impermanent. Treating empirical entities as solid and independent is depicted as a fundamental error in perception, with the underlying reality being relational, collectivist, and intertwined. In contrast with the Western emphasis on individuality, Zehner (1959, p. 308) claims that viewing individuals or any phenomena as self-evident is treated as the primary 'heresy' in Buddhism. Similarly, Hindu, Sikh, and Jainist philosophical schools all argue that reality is ultimately one connected matrix even though unenlightened beings perceive separate, independent entities. A common religious concept in these sects is maya, a word that is often translated as illusion and derived from the same root word as measurement and matrix (Shastri 1911, p. 29). This word suggests that one source of illusions, including the post-Enron financial illusions discussed by Hake (2005), is how we slice and dice our categories of gain and loss across artificial boundaries that separate the firm from non-firm actors in the overall economic matrix.

African philosophy also emphasizes that the relational connections to the group are more important than the individual. Okolo (2002) claims "African metaphysic or theory of reality differs significantly from that of Aristotle"
(p. 212). He maintains that “[T]he universe is not something discrete, but a series of interactions and interconnections” (p. 213). Houonondji (2002, p. 126) agrees when he notes that Africans have a more dynamic conception of reality than the static models that are often assumed in the West (Tefo and Roux 2002, p. 167).

Even in science, measurement and objectivity are not always taken as a given. In the Great Depression era some physicists were already beginning to recognize that hardly anything is as objective and solid as it appears through conventional perception. In his famous lecture on two tables, Sir Arthur Eddington (1928) asserted that there are always at least two physical realities — one of a table which appears to be well-bounded with distinctly measurable traits and another table with indefinite components constantly in motion with inherently fuzzy boundaries. Modern quantum physicists claim that scientific conclusions about reality are affected by researchers’ inherent biases, the measuring tools selected, and a growing consensus that nature does not always play by the conventional logic of cause preceding effect (Deutsch 1997, p. 270). Barad (2007) argues that the physical world should not be characterized as sets of disjoint entities in a linear chain of causation, but is better conceptualized as a series of entanglements; “To be entangled is not simply to be intertwined with another, as in the joining of separate entities, but to lack an independent, self-contained existence” (p. ix). Natural scientist John Muir (1838–1914 CE) foreshadowed the concept of entanglement in modern physics with his observation that, “When we try to pick out anything by itself, we find that it is bound fast by a thousand invisible cords that cannot be broken, to everything in the universe” (Muir, 1910/1988, p. 110).

“Philosophers generally agree that the only propositions that can fully satisfy the fundamental conditions of rationality are self-evident and self-justifying ones, since every other conceivable proposition seems to require precedent justification…” (Bakolo 2002, p. 17). Arguing that entities are self-evident with objectively determinable boundaries can serve as a foundation for universal rules only as long as these assumptions are not called into question. Moock (1989), Jacobs (2011), Ogborn (2014), Ogborn and Jeacle (2002), and Poovey (2001) all maintain that science can never provide truly objective data because normative values are inherent in both the tools utilized and the choice of research questions. Philosophical pragmatists held out a goal of building an accounting structure that could provide objective, scientific data on disjoint categories of data divorced from normative considerations. That goal is impossible if the underlying assumption that the world is made up of unitary disjoint entities is flawed. If economic entities are essentially entangled rather than disjoint, normative questions about how to achieve normative public interest goals are essential.

V. CONCLUSION

This paper has considered emerging narratives that call into question traditional models of the firm as a distinct unit with determinate boundaries. The financial crises of 1929 and 2008 demonstrate that economic units exist within an institutional matrix that may appear stable and permanent, but can be brought to a halt by the interlocking contracts between major players. This paper maintains that the entity concept evolved in an era when individualism was emphasized and normative ideals de-emphasized in the name of scientific objectivity. In anticipation of forming the FASB, an AICPA committee (Trueblood 1973) drew up a list of twelve potential objectives of financial statements. Only one of these focused broadly on “activities of the enterprise that affect society … and which are important to the role of the enterprise in its social environment” (p. 55). This broad public interest objective was rejected in favor of a more narrow focus on the decision making needs of current or prospective investors and creditors.

Financial crises bring into perspective the entangled nature of market relationships and the need to pay more attention to the broader social matrix. Conventional accounting practice and traditional economic theory treats firms as if they are independent stand-alone units. The FASB/IASB accounting conceptual frameworks are built on a foundation that treats normative societal concerns as subordinate to investor and creditor interests. Rather than being value-free, this is in itself an implied normative goal that elevates the needs of some members of society above those of others. Financial crises demonstrate clearly that the inherent connectivity between large firms can threaten the stability of the entire institutional matrix. The disconnect between conventional theory that treats firms as unitary and the evidence that supports a model based on entanglements in the institutional matrix suggests there is a need for renewed emphasis on normative, public interest concerns in economic theory and practice. Apparently not everyone recognizes the irony of how post-Darwinian empiricists avoid grappling with significant public interest issues by using the excuse that normative ideals cannot be measured and resolved ‘objectively’ even as the accounting profession denies the uncertainty and subjectivity inherent in conventional entity boundaries. Examples of normative concerns that need addressing include the relationship between income inequality and the long term stability of a society, the relationship between profits and the environment, and the problem of geographic domicile in establishing an equitable tax structure. Hake (2005) even suggests it may be time to revisit Veblen’s (1904)
observation that the primary purpose of innovative financial arrangements is to allow powerful interests to capture and convert expectations of future returns to their own private ends.

The Public Interest Oversight Board (PIOB) of the International Federation of Accountants was formed in 2005 to signal an enhanced alignment between accounting and public interest concerns. The Center structure recently adopted by the American Accounting Association (AAA) is another initiative aimed at better engagement with constituents beyond the traditional base. AAA projects are on the drawing board to address the scope of acceptable intellectual contributions by the Education Center and to identify viable advocacy activities within the Public Interest Center. These three efforts provide interesting opportunities to re-envision the accounting profession’s role in addressing significant societal issues, but also remind us of the challenges inherent in overcoming what Scott (1931) calls the inherent conservatism within professions. The efforts signaled by the AAA and IFA initiatives are long overdue. Still, there are significant obstacles to any paradigm shift. This would seem to be especially true as long as funding for public interest initiatives, academic theory, and the prestige structure of the accounting profession remain grounded in what has historically been a very conventional philosophical outlook.

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