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A longitudinal study of the interplay of corporate collapse, accounting failure and governance change in Australia: Early 1890s to early 2000s

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ABSTRACT

The "surprise" element of many corporate failures during calamitous periods typically results in criticisms of accountants and auditors and their principles, practices and standards and typically leads to governance reforms including those related to the preparation and audit of corporate financial reports. Set in Australia, this historical study presents the results of an examination of four rounds of heavy and unexpected corporate collapses across a number of sectors which occurred in the early 1890s, early 1960s, late 1980s/early 1990s and the early 2000s. The longitudinal study examines the interplay of corporate collapse, accounting failure and governance change within these periods and seeks to elucidate the continued implication of accounting in corporate scandals despite the governance reforms that were introduced after each calamitous period in order to alleviate or curtail future failures. The study applies an investigatory framework for analysis purposes which draws upon Clarke's (2004, 2007) perspective on cycles of crisis and regulation, Jones's (2011a) model of the potential for accounting failure and the scholarly literature on legal conceptions of rule effectiveness.

1. Introduction

Accounting and audit scandals are not new and are "perennial problems stemming from basic human nature" (Jones, 2011a, p. 499). History has shown that corporate collapse, accounting and audit failure (hereafter "accounting failure") and governance change are inter-related. Accounting failure is particularly implicated in unexpected or surprise corporate collapses involving prominent corporations. High profile examples of company failures of the genre in the early 2000s included Enron and WorldCom in the US, Parmalat in Europe, Equitable Life Assurance Society in the UK, and HIH Insurance in Australia. This phenomenon is not new or quaint (see, for example, O'Connell, 2005; Carnegie and O'Connell, 2011; Jones, 2011b) and is "unlikely to go away" (Jones, 2011a, p. 499). In response to instances of accounting failure occurring within rounds of corporate collapse, governance change is typically proposed and adopted in an attempt to ensure that such instances do not arise again in future. Notwithstanding the good intent behind such governance reforms, corporate failures have been shown to be cyclical, especially occurring during periods of economic downturn, and typically leave the accounting profession struggling to defend its legitimacy. Repeated unexpected corporate collapses lead to further governance change that is intended to ensure, as far as possible, that the errors, misjudgements and negligence of past actors

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do not recur. Governance change typically encompasses legislative reforms relating to financial reporting or audit involving amendments to corporations/companies legislation and other pertinent laws. The reforms may also involve the issue of new or amended pronouncements by professional accounting bodies or the establishment by the profession of standard-setting agencies as well as amendments to stock exchange listing requirements or codes of governance.[1]

Corporate scandals up to the time of writing in Australia have not been unusual and typically arise in sizeable proportions during economic downturns following periods of rapid economic development or transformation. Such conditions are exacerbated during periods of rapid economic growth when there is little or no effective company regulation in respect to accounting and audit under the relevant company legislation as was the case during much of the colonial era in Australia until the passage of the Victorian *Companies Act* of 1896 (Gibson, 1971, 1979).[2] Such circumstances were evident in Eastern Australia during the early 1890s economic depression. Since that time other rounds of heightened and excessive corporate collapses across a range of sectors, where accountants and auditors were implicated in the failures, have been experienced in Australia, most notably during the early 1960s, late 1980s/early 1990s and the early 2000s. Australia experienced the effects of the worldwide share market downturn of 1929 and the related economic depression, particularly relating to the decline in international demand for its primary products, but "there had not been the securities malpractices which came to light in the U.S.A." (Gibson, 1979, p. 26). According to McCalman (1995, p. 53), the great difference between the 1890s and the 1930s depressions in Australia "was the ease with which the middle class survived the latter catastrophe" while the wealthy and middle classes were impoverished by the 1890s depression. Given the retention of the middle class in the 1930s and the austerity measures generally applied, Australian companies and individuals, tended to tough out the difficult economic times, leaving the legitimacy of the country's accounting profession intact.

Drawing on extensive primary and secondary sources, this longitudinal study links together four prominent and regrettable periods (that is, early 1890s, early 1960s, late 1980s/early 1990s and early 2000s) of corporate collapse, accounting failure and governance change in Australia. The study's aim is to examine the interplay of corporate collapse, accounting failure and governance change across this extended time frame. The study, therefore, addresses the continued implication of accounting in Australian corporate scandals despite repeated governance reforms that were introduced to alleviate or even avoid future case studies.[3] The study, however, has not endeavoured to evaluate the effectiveness or ineffectiveness of any single governance reform, whether adopted in the 1890s, the 1960s, the 1980s/1990s or the early 2000s, but rather has sought to focus attention on the overall effectiveness of governance reforms in preventing corporate and accounting failure across time. A common investigatory framework is applied across a long time span of approximately 110 years in interpreting the findings in respect to all four rounds of major corporate collapse. Specifically, the perspectives comprising the investigatory framework are Clarke's (2004, 2007) perspective on cycles of crisis and regulation, Jones's (2011a, p. 499) "theoretical model" of "the potential for creative accounting and fraud" and the scholarly literature on legal conceptions of rule effectiveness. With its focus on accounting in crisis, the study is intended to elucidate the lessons of history from the dark side of accounting.

This longitudinal study is intended to augment the literature in several ways. First, it dates from the early 1890s during an unregulated phase of accounting development in Australia and permits an assessment of collapse-related governance reforms following the earliest round of major corporate collapses. Second, the study examines all four rounds of significant corporate and accounting scandals in Australia across a time horizon of approximately 110 years and the respective governance reforms which followed each round of failure. This wide time horizon has enabled the examination of numerous governance reforms following rounds of collapse on a holistic basis and with the benefit of being able to reflect on the long-term ramifications of these initiatives. Third, the study throws light upon the inherent limitations and weaknesses of earlier rounds of key governance reforms that were introduced following corporate calamities. The study, therefore, potentially permits a richer and better informed critique to be provided of the overall effectiveness of governance reforms than would have been possible if the time span of the investigation was short or the study was conducted soon after the adoption of those reforms. Fourth, the study examines the phenomenon from the early 1890s to the early 2000s using an interpretive framework that is commonly applied across all four rounds of corporate collapse for analysis purposes. Previous studies of the genre tend not to draw upon explicit interpretive frameworks.[4] Fifth, the study may contribute positively to challenging our conceptions of contemporary accounting and auditing and provide insights into accounting policy setting and regulation for contemporary decision makers, including politicians, regulatory agencies, standard-setters and policy makers, among others. Sixth, the study may stimulate other accounting historians to conduct similar longitudinal studies elsewhere and, if so, may enhance an understanding of the interplay of corporate collapse, accounting failure and governance change across both time and space.

[1] Refer to Shleifer and Vishny (1997), Clarke (2007), and Solomon (2007), among others, for an overview of corporate governance.

[2] Australia once comprised six British colonies until Federation occurred on 1 January 1901 when the colonies became known as states.

[3] Corporate collapses in Britain, as the "mother country", have also contributed to legislative responses in Australia, especially in Victoria, some of which were subsequently adopted in British company legislation (see, for example, Gibson, 1979; Parker, 1986). The Royal Mail case of 1931 resulted in legislators in Victoria introducing requirements in the *Companies Act* of 1938 extending the disclosure provisions "to require adequate profit or income statements" as well as "the presentation of consolidated statements" for corporate groups (Gibson, 1979, p. 26). Similar British legislative changes were not introduced until 1947 (Parker, 1986).

[4] Exceptions include Carnegie and Napier (2010) and Carnegie and O'Connell (2012).

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