Accounting, Organizations and Society 42 (2015) 12–31

Contents lists available at ScienceDirect

Accounting, Organizations and Society

journal homepage: www.elsevier.com/locate/aos

Transplanting Anglo-American accounting oversight boards to a diverse institutional context

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ARTICLE INFO

Article history:
Available online 14 February 2015

ABSTRACT

The introduction of accounting and auditing oversight boards (OBs) has been promoted on a global scale as a key component of the international financial architecture that has emerged over the past two decades. Such institutions, modeled on the Anglo-American tradition, are domestically organized and embedded within distinctively diverse institutional contexts. Their role is to ease agency problems, improve the quality of financial reporting, and help provide stability in the global financial system. We employ an institutional approach, located within the broader political economy framework of global capitalism, to examine the establishment and operation of the new regulatory regime in Greece. Greece, a member of the European Union, exhibits characteristics of a "delegative" democracy, i.e. a traditionally weak institutionalization, reform (in)capacity problems and a clientelistic political system. Our case study shows that the formation and operation of the newly-established system of oversight is conditioned by local political and economic constraints and, thus, does not automatically translate into concrete benefits for the quality of financial reporting. We also draw attention to the structural mismatch between a progressing globalized financial integration and the fragmented nature of the system of oversight, and illustrate that OBs' independence from local governments is an important but neglected issue.

Introduction

Internationally, the history of corporate accounting and auditing is replete with failures and scandals, followed by waves of regulation (e.g. Malsch & Gendron, 2011; Zeff, 2003). In the past two decades of advancing globalization, reforms in the accounting domain have taken place within what Wade (2007a) calls the Standards–Surveillance–Compliance (SSC) doctrine, a regulatory framework of globally-integrated financial markets that aims to provide stability in the marketplace (Büthe & Mattli, 2011; Davies & Green, 2008; Wade, 2007a, 2007b). This new dogma entails the use of comprehensive and universal standards, as well as codes of good practice, whose application would be overseen and enforced by a gamut of regulatory institutions and agencies – official or unofficial, national or global (Cooper & Robson, 2006; Humphrey, Loft, & Woods, 2009).

A key element of the emerging international financial reporting infrastructure is the introduction of systems of oversight for accounting and audit practice, independent of the profession, which appears to signal an end to the tradition of self-regulation. Accounting and auditing oversight boards (OBs) serve as a basic mechanism for tackling perennial problems in corporate financial reporting and

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http://dx.doi.org/10.1016/j.aos.2015.01.001
0361-3682/

auditing, within the broader complex and hierarchical global regulatory system (Arnold, 2012; Humphrey et al., 2009; Wade, 2007a). OBs emerged in the US under the Sarbanes–Oxley Act (US Congress, 2002), in the EU under the (new) Eighth Directive (European Commission, 2006), and in other countries (Malsch & Gendron, 2011). Their establishment rests on the assumption that they can operate efficiently and effectively to ease agency problems, improve the quality of financial reporting, and help to restore the trust of investors and the public (European Commission, 2001a, 2006, 2010; US Congress, 2002, 2010).

The system of oversight for accounting and auditing is domestically organized and embedded within distinctively diverse local political, economic, legal, and cultural contexts (e.g. Kaufmann, Kraay, & Mastruzzi, 2013). O'Donnell (1994) argues that, for historical and socio-political reasons, some countries consistently exhibit a marked weakness in introducing social and economic reforms and in building strong and functional institutions of horizontal accountability. These countries, termed by O'Donnell as "delegative" democracies, are characterized by a highly clientelistic political system and state ineffectiveness, standing in contrast to other countries that have shown a history of successful reforms and strong institutionalization. Thus, the effectiveness of the operation of OBs at a domestic level warrants in-depth empirical evaluation (Arnold, 2012; Malsch & Gendron, 2011), given their importance for the stability of the global financial system (Wade, 2007a, 2007b) and the variability of local institutional backdrops (Dyson & Goetz, 2003; O'Donnell, 1994).

In this article, we adopt an institutional approach located within the broader political economy framework of global capitalism (Arnold, 2009b, 2012; Wade, 2007a, 2007b; see also Chapman, Cooper, & Miller, 2009) to examine the creation and operation of an OB in a local European setting. We focus on O'Donnell's (1994) conceptualization of delegative democracy and supplement our framework with literature on Europeanization, which indicates that reform (in)capacity problems and weak institutionalization occur even within the EU and the euro area (Dyson & Goetz, 2003; Featherstone & Papadimitriou, 2008). We place emphasis on the interaction between global structural elements, institutions, influences and pressures (namely, the unfolding of the SSC project), and on local socio-political characteristics that may condition the establishment and effective operation of OBs at the local (state) level. Our focus is Greece, which offers a clear vantage point for examining the issue at hand for two main reasons. First, the country is known for its clientelistic political system and well-documented reform (in)capacity problems (e.g. Featherstone & Papadimitriou, 2008). Second, Greece has been in a deep, multifaceted crisis since 2008 (OECD, 2011a, 2011b), illustrating the importance of each nation to the stability of the new, complex, and interdependent international financial system (International Monetary Fund, 2013).

With a wealth of empirical material (written evidence and interview data), our national case study illustrates the difficulties and limitations in transplanting Anglo-American (Arnold, 2012) reforms to a diverse socio-political local context. Our study shows that the political practices of clientelism and party patronage, as well as bureaucratic control by the government and a widespread mentality of inertia within the broader state apparatus, have affected ELTE,[3] the Greek OB, since its inception in 2003. As a result, ELTE has remained essentially dormant. In this study, we show that ELTE has failed to become a significant player in Greek accounting and audit practices and demonstrate that improvements are urgently needed in the quality of Greek financial reporting and auditing (Caramanis & Papadakis, 2008; Christensen et al., 2013; Leuz et al., 2003; Osma & Pope, 2011).

This article extends prior work on the establishment of the Greek OB (Blavoukos et al., 2013) and contributes to emerging international academic literature on accounting and auditing oversight (e.g. Malsch & Gendron, 2011) on several fronts. First, our paper employs O'Donnell's theoretical conception of delegative democracies within a broader political economy framework to create the theoretical backdrop for investigating how local socio-political constraints condition the establishment and operation of an imported institution – a subject that is currently high on the global agenda. In particular, we show that the Greek OB has been stymied since inception by pre-existing local structures and remains essentially a dormant institution, providing no concrete benefits to financial reporting quality. Second, whereas the current system of oversight puts emphasis on ensuring the independence of OBs from the auditing profession, we illustrate that independence from government is an equally important but essentially neglected issue. Specifically, we argue that, while existing arrangements may have saved the oversight system from the Scylla of professional control, they have sailed too close to the Charybdis of state meddling.

Thus, our study draws attention to the structural mismatch between a progressing integration of the interdependent global financial system and the fragmented organization of accounting and auditing oversight on a domestic (national) level. This mismatch raises the question of the effectiveness of local OBs, given the diversity of the domestic socio-political contexts within which they emerge and the rather elementary level of current international or regional (e.g. EU) coordination (Davies & Green, 2008, pp. 89–91; Humphrey et al., 2009).

Our study is of relevance to several other countries that exhibit, albeit to varying degrees, a tradition of party patronage, clientelism, institutional weaknesses and state ineffectiveness. The findings have implications for various actors and stakeholders in financial reporting. For example, global regulators should realize that independence from the profession, while simultaneously ignoring local institutional impediments, by no means guarantees the operation of effective national OBs across the globe. Furthermore, in the absence of effective oversight, particularly amid a severe financial crisis, there is a real risk that the quality of auditing will fall and audit fees will plunge, conditions that may bring about a major legitimation crisis for the profession.

[3] The full Greek name of ELTE is Επιτροπή Λογιστικής Τυποποίησης και Ελέγχων – ΕΛΤΕ (Epitropi Logistikis Typopoisis kai Elegchon – ELTE), which translates as the Accounting and Auditing Committee).