What Shall We Say Is Better Accounting?¹

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Some of you may already know that the American Accounting Association, in collaboration with four other international academic accounting associations from Japan, Canada, Europe and Australia-New Zealand have set up annual Yuji Ijiri Lecture on Foundations of Accounting. Each year, one of these associations will host the lecture at its annual meeting starting September 4, 2018 in Yokohama, Japan, annual meetings of the Japanese Accounting Association. The second lecture will be delivered at the August 2019 annual meetings of the American Accounting Association. This will be followed by lectures at other associations. It is hoped that this international lecture series will help draw attention to scholarship on foundations of accounting. The associations will invite scholars from various parts of the world to deliver this lecture each year. The first lecture in September 2018 is being delivered by Professor Shizuki Saito, professor emeritus at the University of Tokyo on “Reconstructing Accounting Research: Beyond Theory without Data and Data without Theory.”

I would like to explore possible answers to a question: “What shall we say is better accounting?” Perhaps the answer is obvious to many; please share your thoughts for benefit of us all. Consider this quote from the preface of Ijiri’s Foundations of Accounting Measurement (p. ix):

• In recent years we have seen numerous [efforts] dealing with contemporary challenges to accounting … the response to the challenges should be made keeping always in mind the effects of this response upon accounting foundations. Otherwise, accounting will soon become simply a patchy collection of practices.”

Some people might argue that this is where we are now, and it is a good time to start thinking about foundations.

Everybody wants better accounting, but what is better is unclear. MC Escher’s drawing (Figure 1) makes it difficult to know which way is up. If you visually follow the people

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moving clockwise, they are going round and round climbing the stairs, always going up yet staying in the same place; if you follow those moving counter-clockwise, they are going round and round, always climbing down the same stairs repeatedly. Every part of the picture is perfectly logical and geometrically correct. Yet, the whole is a ridiculous impossibility—a specialty of M.C. Escher. I shall return to his work later.

What should be the meaning of “better” as applied to accounting? There are several possibilities we can consider. In matters of collective choice, we also need to allow for the possibility that different people or groups may prefer different kinds of accounting, imparting a political aspect to the problem. Sometimes when people get tired of unending debates on “what is better”, they may switch instead to a frequently easier task of developing a process—or means—by which the accounting system is chosen, and make a commitment to comply with the outcome of the process.

Fortunately, this problem is hardly unique to accounting; it is present in many disciplines. Perhaps some judicious combination of its structural properties, regulation and compliance, tradition and social norms, and market competition and innovation, might help us arrive at a reasonable institutional solution. It may require us to combine elements of constructivist and ecological rationality and reasoning. There is some merit in creating good processes and institutions instead of focusing on the choice of specific rules, although the latter tend to receive most attention in accounting. I shall try to make a case that the attention should be shared between the specifics and larger perspectives.

**Multiple Perspectives on Meanings**
Consider four classes of meanings of “better”: based on attributes, goals and functions, specified procedures, and social practice or convention. Attributes sought by better accounting could be truth, other qualitative attributes, or some statistical and descriptive properties of the contents of accounting reports—which is very popular in accounting research over the recent few decades. Accounting may serve some broad societal goals or functions or serve some the goals of some specific individuals or groups. We can also define accounting by specific procedures. Finally, it can be defined by its social acceptance in practice as a convention—the origin of generally accepted accounting principles.
It seems fair to say that while the practitioners—and more recently the academics—seem to have handed the task over to the authority, the latter has not been effective in developing a clearer idea of what is better accounting after some 75 years since the SEC’s creation. That somebody in Washington will do the thinking remains a false hope. Simply claiming to deliver “high quality standards” without stating what quality is, is a scam, especially in a discipline devoted to measurement. Physicians, for example, provide healthcare as measured by longevity, cure and mortality rates, even without much standardization of their practice. How important is standardization to accounting practice? Does the issuance of written standards help improve accounting? We don't know, and authority hasn't helped much. I think academics need to start paying some attention to it. Let us take some preliminary steps.

The authorities do not claim to balance the interests of various parties because that would present them with a political challenge they are not equipped to handle, and do not have the social legitimacy to carry out. Instead, they claim to provide information for users, as if users are the only relevant decision makers. Prepares and auditors are decision makers too. Applying the fineness criterion of informativeness from Blackwell’s theorem to accounting only results in a roomful of data dump of accounting records which would be unintelligible to all but the experts. It does not help decide what good accounting might be, which is the question we are trying to explore here.

Attribute-Based Approaches
When a laymen is asked what kind of accounting they want, chances are that they will ask the accountant to tell the simple truth. The problem is that often what is true cannot be stated in simple terms, and what can be stated simply is often not true. To many people, historical cost as well as mark-to-market accounting have different claims, and the readers are familiar with various arguments about which one is true and fair which is not. This attribute (like most other qualitative attributes to be discussed later) does not guide making tradeoffs. However, like honor/ethics codes in universities or professions it has a strong aspirational appeal. The U.S. Declaration of Independence is a good example recognizing inalienable human right to life, liberty, and pursuit of happiness. It is not used for settling cases in courts of law, and yet, has been a powerful guide to human aspirations and constitution writers around the world over centuries. Second, consider this statement by former U.S. president Lyndon B. Johnson about the Great Society programs.
“The great society is a place where every child can find knowledge to enrich his mind and to enlarge his talents... It is a place where the city of man serves not only the needs of the body and the demands of commerce but the desire for beauty and the hunger for community... It is a place where men are more concerned with the quality of their goals than the quantity of their goods.”

Johnson’s statement is aspirational, not to be implemented in letter but in spirit. That is where true-and-fair criterion in accounting also belongs. It cannot be treated as a rule or standard for inventory valuation; indeed it is our protection when application of such specific rules yield unacceptable big picture.

Second attribute-based approach answering the question of the meaning of better results to qualitative properties. have been descriptive properties. You've seen this kind of list I'm sure you can add a few other items to these things and many of these criteria are conflicting and of course when you depend on quantitative attributes we have no idea how to make tradeoffs among them. And so it can take you some certain distance but won't take you to a unique position. I give you the same criteria to five people and say OK yeah there are two methods of accounting. Tell me which is better by these criteria and they'll come up with different answers. No it doesn't give you the same answer. So no guidance for trade offs, conflict on desirability among various kinds of agents and ambiguity of meaning many of these things have very ambiguous in meaning I won't go into the details about that ambiguity or the source of the ambiguity. But they are ambiguous and not clear cut. These days accounting literature’s most popular criterion is producing data and disclosures with desired attributes. Our most popular one these days is correlation between financial reports and the stock market data very popular or other variables listed SQL variables value relevance is a very catchy term that appears in all of our papers and journals. Include you know of some standard setter might say include consolidation of control entities has a consolidation criterion that can make things better or include quarterly results. This morning our president tweeted do not include quarterly results, just put half yearly results and they are asking the SEC to change from quarterly to half year, include new disclosures no financial instruments balance sheet financing uncertainties, separate core from non core business long kinds of these things people make arguments are these are whatever they are arguing for will improve financial reporting. PSLRA 1994 are allowed inclusion of forward looking information. And some people argued that Enron was a result of
PSCLRA. It allowed people under the safe harbor rule to include unverified information in their financial reports. And all these generate a certain risk of disclosure dump. I think there was a nice paper by Bloomfield who argued what happens if you keep increasing disclosure to 500 page financial reports and then you can't. It was very easy for Enron to stick in information - they disclosed it, but they didn't want you to read it. What was buried under all those pages very few people found and the person who found it first was actually an English major, a young woman who actually had no accounting education, by the way.

So more disclosure does not make it better it? You can decide for yourself. You know you can decide what then there's the meaning of this is so broad societal goals of functions creation of wealth or livelihood nice things to say promotion of social cohesion justice that distribution issues in society creation of markets for physical financial and human capital that promotes economic efficiency creation of operation of organizations to create and distribute social surplus coordination and disciplining of individual participants in organizations in society. So personal pursuits do not all of their collective functions. Discipline alternative and competing source of information. To add stability and predictability to organization reduce organizations cost of capital that is very iffy but we can talk about it for an hour. So I'm not go there right now. Our difficulty of linking accounting alternative to attainment of such social goals.

So the social goals are easy to specify but how do you make accounting methods do these social goals even ex-post linking is difficult.

Ex ante I think it's almost impossible. In our PhD preliminary exam I wrote a question. The question was the SEC security and exchange commission is considering a proposal to make this issue the rule for the future. Make this change in the future and about 10 times in the two paragraphs of the question I mention it is a proposal to be implemented in the future. Tell us how you would analyze the effect of this proposal and prepare a report for the SEC. When I got the answers from of the students, I got an event study. Now, I know a little bit about event study. I started doing that in my thesis in 1972 but that's only one idea because I think I you know what I was there to learn could be learned. But now they had no idea of policy decisions. They have to be assessed ex ante before you implement it.
We are a little bit more detailed on the previous slide facilitating efficient operations helping create maintain better markets better management of public finances better macro economic management create counter ability relationships Yuji talked about that. It was discussed earlier create and communicate and forced contract that I talk about my theory book and provision of information to relevant economic agents. That's what you're talking about and what they mention in their official state.

Yes. So. And then there's chaos.

[00:25:26] Some people say serving some individual schools so enabling participants in the organization to make better informed private decisions to improve their own individual welfare. And there are several sources of ambiguity in that serious ambiguity that diverse goals and informational demands of groups of participants may include that metrically opposite. Equal weight should be put to all interests or unequal rates. How do we decide on that and need of individuals that depend on the personal circumstances to change dynamically unknown and unknowable to others. Oftentimes it assumes no interaction among the individual decisions and of course as you pointed out earlier Dembski and Black work in 1973 and Black close to them and you know issues some difficult problems for this kind of approach.

So simplify you could simplify that by narrowing the focus on serving a single individual. You select some individual action like I like beer.

Okay. Accounting will we designed - so who's a favorite person these days? Favorite group? Shareholders and so are shorts. I think mostly it is kind of relatively new. You think about it. You know. I take it was rooted in myths largely so I see it misunderstanding of Milton Friedman's a widely read article. Profit is the only goal of business because what is misunderstood there is he makes it very clear that article within the constraints of the law.

And the rules and norms of society and that part is often forgotten in that so sometimes it's transformed into maximizing profit. We talked about Enron this morning so the day the bad news came Enron stock price was in the 90s right and it fell to something like half a dollar in a few days. The lawyers who wrote the report said that Enron at that time
was worth about five dollars to the last of the shareholders. Was it 90 minus 5? Or 90 minus 50 cents?

Had Mr. Skilling created value for the shareholders by maximizing shareholder value to 90? What do we mean when we say maximize shareholder value about business decisions? In any case, shareholders not only in the society with the relevant interests and informing shareholders for better investment decisions is not the same thing. As Financial Reporting that will increase the stock price and a chance. Are procedural perspectives people can decide on computerized? Blockchain was mentioned earlier distributing systems continuously audit two systems are being developed these days are being implemented actually a regulatory compliance based systems. And finally I should mention he can also look at accounting social practice or can mention with simply continues by tradition and by commission with no documentable connection to any putative goals. Examples - raindance. You do a raindance and draw what conclusions? If it rains, it is a success. If it doesn’t rain, maybe it was not right – the feast did not have enough food, the dancers were not good enough, the drummers were off beat - something was not right. Wedding ceremonies, university commencements, research publications, workshops, conferences, faculty meetings; does anything useful happens here? They are mere conventions. I love conventions. I won’t go into all of my thoughts about that; what the accounting is for. It could be for attributes of various kinds of attributes I talked about it could be for various functions and goals it could be for just defining the procedures. It could be as a convention or ritual. I haven’t seen much by way of agreement on this. So if you can find agreement on what it should be that would be great. Sometimes we settle as a social practice. We settle on a process. You might not agree on what a particular law ought to be on a particular matter. But we say OK we agree on this constitution for the United States and we’ve set up a process of elections and legislatures that make those rules or regulatory bodies and people abide by it.

Let’s talk about process. Oh well the regulatory agencies one they learned the fallen executive branch. Yeah but I think our under the president appoints them. And though in fact this Consumer Financial Protection Bureau was challenging on those grounds that there was some disagreement about that and they went to the court of law. But I think with respect to the other regulatory agencies like FCC, SEC. Those issues were really litigated in the 1930s and early 1940s and that consent to Maliki was settled by the Supreme Court. You may not agree with that but those things have passed that at least
the constitutional test. According to the Supreme Court again the same thing applies. We agreed to the process to rectify disagreements whether it's OK or not. We'll go to the Supreme Court and these nine people through their votes will decide and after they decide we'll sit quiet.

There's a process. So let's look at these processes. But before going to a list of scenes like this the three general approaches design approach dropdown design approach picture quite sufficient understanding of the structure. The problem solved. It's like solving our bread equation using this knowledge which is called constructive rationality. But the problem as Hayek pointed out was imperfect knowledge effectiveness of successive attempts depend on stability and continue to be off that in that domain. So the second is emergence which is opposite of top down. It's a bottom up from complex poorly understood interactions among many elements through a process that includes much randomness and that's ecological irrationality or evolution and you are familiar with biological evolution or expenses Turris or social evolution that could be the emergence and there are many of many examples. OK so let's talk about these processes are Heysel possible list. Common law popular vote or referendum legislature is statutorily law courts administratively and regulatory agencies self-regulation and markets. I won't go into each one. In practice multiple parts of these things could be used and were until the creation of SEC a good part a large part of it large part of accounting was driven by common law and the generally accepted accounting principles GAAP indicates Aldrich's idea just you know came up popular vote referendum is too technical for that purpose.

Legislative is a statutory law. Of Time has been avoided because it would be hard to educate legislators on the subject. Of course that was suggested by Spacek who was head of Arthur Anderson in 1958. In a very nice accounting review article, she argued that what we need is an accounting core in which these disputes would be taken to account in court and accounting will double up as case law or criminal rather than the written down rules by boards of course that Basel rules are not accepted and we created this creative agency regulatory structure of SCC and FASB.

In any case, I'm going to skip this. So there are processes that we could settle on and skip some slides which talk about this. What is missing here. Last talked about so far is
stability emergence robustness to financial engineering. You probably know our solidarities better locks and Surtees bear locks a very simple idea.

Go back to the Greek times if you take a heap of sand. Okay you say a world is this all of you. Tell me this or the heap of sand.

I think a grain of sand out so is a heap of sand. I've taken all the grain out what is the process. I keep doing that. When will this cease to be a heap of sand?

That's a problem with accounting standards too. English words all get subject to Sorites paradox. So they have to fit with local business and learning environment. We are dealing with learning systems because people are not sitting idle in response to the county rules you write. So you recognize endogeniety of transactions and complexity something that Ron and John and I have written about little bit. So all right let me so there are certain balancing might be needed

To move in this field but I think in recent decades especially since creation of SEC gave me such incredible faith in our ability of the two standards to solve our problems.

And I'll give you two more examples of that. But what is better accounting and how we might get there seems to be still an open question. They need more attention from us. I think looking at components of the system is important for constructivist approach to irrationality but looking at the whole is also especially important from an ecological rationality perspective. I'll give you just a couple of examples briefly. How somebody likes a friend.

I was talking to someone in Canada yesterday. Now this recent demand from Canadians to the Canadian standard setter. Canada has basically accepted IFRS for most purposes as GAAP. There are so many corporations using non-GAAP, now they wan't rules for non-GAAP.

Let's imagine, you play a game of football and lot of people start violating the rules of football. What do you do? You write, not revise, the old rules - you leave them in place. But now we're going to write rules about which violations are ok and not ok. John, didn't
you tell me that the SEC is now approaching the same thing? Can you imagine the non-GAAP standards? What does that mean? When you figure it out, please tell me.

I will get back to MC Escher, my favorite. All right take a look at this. Now look at this part of the picture - there's a waterfall forming on this wheel and the wheel is running the mill there, and this water comes down and flows down this channel. This channel is going down down down down down down down and water falls there. Every part of this system is logical.

Look at this part, and this, every part is logical so far. What exactly are we looking at? Are we looking at xxx the naked picture? You can sit down and see every blade of grass and even the roots and you can take the camera down and look at even further details of this. You can learn more and more about the lawn. Can you learn more by getting into more detail? Yes, you can.

Look at the picture on the right. Where does this picture come? This was the first picture of earth taken in 1968 from the first Apollo mission which left Earth without people. It was a trial basis and then it got about a hundred thousand miles away from Earth. It took a picture of Earth as a blue marble hanging in a black sky. This was the first time human beings saw this. It illustrated how all six billion of us are born and are going to die on this. What did it do? What did this photograph do? It kicked off the environmental movement. Impact of this photograph is incredible. What does it tell you?

Well you learn different things from different perspectives. You learn things by analysis going into details. Adding one more or three more or ten more explanatory variable of regression to push up the R-square where you learn something else if you step back and look at the bigger picture and see what's going on. I hope we get it. I think Yuji taught us all to look at the bigger picture. We can do that. Thank you.
Figure 1: Which Way is Up?
(Source: M.C. Escher Archive on Internet)