Better Financial Reporting: Meanings and Means\(^1\)

Shyam Sunder

Yale University

Abstract

What could be the meaning(s) of better corporate financial reporting? How can financial reporting be improved? We may start by recounting and examining various claims of shortcomings of financial reporting. Conflicts among these claims point to the political elements of the problem inherent in collective choice in society. Since “better” depends on the interest group whose perspective is chosen for analysis, politics lies at the heart of accounting. The set of possible means of arriving to any agreed upon meaning of “better” includes not only regulation, but also social norms and market competition; a judicious combination of all three may help us improve financial reporting. This paper attempts a broad examination of the meanings and means of better financial reporting.

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Accounting for markets, but not only for markets. We must also consider other legitimate perspectives in discussing better financial reporting.

Abstract

Introduction

Meanings of better financial reporting

Attribute-based approaches
- Pursuit of truth
- Balancing specified attributes
- Statistical and descriptive properties

Goal-based approaches
- Social goals
- Goals of specified individuals/groups

Social practice

1. Introduction

How do we think about and design a better financial reporting regime? The topic has received much attention during the past century. Perhaps the first step in making progress is to recognize that the problem of designing such regimes and standards is not unique to accounting. There are more than five hundred domestic standard-setting organizations in the United States alone and many more in other countries, defining the technical and business environment and setting standards for everything from ships to shoe laces. In addition, there are international bodies that do the same for things such as radio transmissions that are apply across the national boundaries. An examination of the regime setting of accounting in the larger context of society for other products and services may help us appreciate the costs, benefits, limitations, and economics of developing a better financial reporting regime (Jamal and Sunder 2011).

2. What is better financial reporting?

Attention to this question has yielded diverse answers. Let us start with a six-way classification of the perspectives used to identify "better" in financial reporting. Three of these are based on attributes of financial reporting, two view financial reporting as instruments for serving specified goals, and one is procedural. The attribute-based approaches include (1) pursuit of truth, (2) assessment based on specific attributes of the reports considered desirable, harmful, or deserving a balance, and (3) some measurable statistical or descriptive properties of the data, disclosures, and explanations contained in the reports. The two functional approaches are the efficacy of financial reporting in serving either some broad societal goals, or the goals of one or more specific classes of participants. A final approach sees accounting simply as a social practice or a ritual, not necessarily related to any specific attributes or goals.
Given the nature of collective choice and social policy, it is rare for any such attempt to clearly identify what better financial reporting is. Trade-offs must be made in presence of non-commensurate and conflicting attributes, as well as within- and across-person objectives. The absence of even reasonable data on preferences, costs and benefits lead to ambiguous conclusions. Indeed, caution is necessary because it is a challenge to be both knowledgeable and confident about one’s formulations.

2.1 Serving societal goals

That financial reporting should serve broadly defined societal goals such as creation of wealth and livelihood, promotion of social cohesion and justice, and creation of markets for certain types of physical, financial and human capital that promote economic efficiency is widely supported. However, like other broad propositions, broad agreement on which financial reporting regimes are better at attaining such goals is unlikely.

Higher material well-being of society today is a result of organizing individual talent and effort in large and small groups, and linking them so they can interact in flexible, transient but predictable ways. Existence and functioning of these organizations in public and private sectors is made possible by financial reporting. Organizations gather physical, human and financial capital and organize it to produce social surplus; this surplus—the excess of production over the sum of opportunity costs of inputs—is their economic contribution to society.

Accounting and financial reports are necessary for organizations to attract various forms of capital, and ensure that the contributors have a reasonable chance of receiving their share of returns on their respective contributions (Sunder 1997). In this sense, financial reporting is necessary for organizations, including society as a whole, which is another larger organization, to sustain itself.

In a world where individuals seek their own respective goals, financial reports help organize them into coordinated networks, inform them about the functioning of the network, as well as discipline individuals so their personal pursuits do not overwhelm its collective functions. Financial reporting disciplines not only the individual actions but also alternative and competing sources of information they may have access to. In this sense, financial reporting helps create stability and an element of predictability to the functioning of organizations.

It has often been claimed that an important function of financial reporting in business organizations is to help reduce their cost of capital. This argument is subject to two objections. First, what is cost to a business organization is profit to the investor. To claim that financial reporting should be chosen to reduce the cost of capital is equivalent to claiming that it should be chosen to reduce the returns to investors. Second, cost of capital is just another price (a rate of exchange) of a factor of production, and it has not been shown that lowering the price of capital (or of potatoes, for that matter), improves social welfare because society includes both the consumers as well as the farmers.

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2 Increasing financialization of society, in the form of creating markets in which all kinds of capital may be exchanged for money, also has its limitations, and has been the subject of severe criticisms, especially in the aftermath of the Atlantic Financial Crisis of 2007-2010.
2.2 Possess desirable attributes

A second approach to improve financial reporting is to focus on its attributes. Over years of accounting discourse, faithful representation, timeliness, relevance, reliability, verifiability, uniformity, consistency, comparability, cost-benefit efficiency, conservatism, and robustness to manipulation and fraud are among the proposed attributes of a preferred system of financial reporting. In the context of governmental organizations, transparency, public accountability, and citizen empowerment and engagement with the organization are often added as a desirable attributes of their financial reporting.

Most of these attributes are widely discussed and largely accepted to be desirable in financial reports with three important caveats. When choosing between two or more alternative practices, such a list of desirable attributes inevitably forces the rule maker to make difficult trade-offs between various pairs, say, faithful representation and timeliness, and between relevance and reliability. The list of attributes itself provides little guidance on making such trade-offs to improve financial reporting. Second, it is difficult to resolve conflicts among the interests of prepares, auditors, and users; what is desirable to one group is not necessarily so for the others. Third, the meaning of terms such as uniformity, comparability, and conservatism, which is obvious at some distance, tends to become indistinct on closer scrutiny. Uniformity of classification of transactions has no obvious interpretation when transactions have multiple attributes, because “similar treatment of two transactions which have any similarity” and “dissimilar treatment of two transactions which have any dissimilarity” yields radically different solutions to the problem of uniformity (Sunder 1983, 1997 Chapter 9). Comparability in a world where no two transactions or events—subjects of accounting classification—are exactly alike is similarly undefinable (Weinberg 1992, Chapter 2, “On a piece of a chalk”).

2.3 Serve goals of individuals

Addressing the interests of various classes of participants in an organization is a third approach to give meaning to better financial reporting. Enabling them to make better-informed private decisions of their own is mentioned often. In this decision-making perspective, it is assumed that the participants have their preferences and objectives, which they combine with information from financial reports and alternative sources to formulate and solve their decision problems. More broadly, this meaning of better financial reporting can be said to help the participants of an organization to improve their individual and collective welfare.

Four sources of ambiguity arise in this meaning. The goals and information demands of various groups of participants do not coincide across, and even within, the members of groups. It is difficult to choose a financial reporting system to serve a diverse assembly that may include diametrically opposed interests. A second problem is that information needed by individuals may depend on their personal circumstances, which change dynamically, and are unknown and unknowable in a credible manner to the selectors of the financial reporting system. Third, individual decision usefulness criterion for better financial reporting assumes independence, i.e., little or no interaction among their decisions. But interactions among rational decisions of “better informed” individuals may yield less desirable outcomes for some or all of them, as compared to outcomes from not-so-informed decisions. Fourth, as Demski
(1973) points out, from Blackwell’s theorem, we know that a better information system for individual
decision must be strictly finer, and this fineness condition is not likely to be met by any standard, with
the possible exception of Sorter’s (1969) events approach to accounting, a topic to which we return in a
later section.

These difficulties with defining better financial reporting in terms of information for decision making has
often been sought to be ameliorated by narrowing the presumed target of financial reporting to a single
group—investors, sometimes narrowed even further to shareholders. Although the vast literature that
adopts this “shareholder perspective” on merits of financial reporting rarely articulates its rationale, we
can venture some guesses. First, and most plausible reason lies in the large following of Milton
Friedman’s widely misunderstood dictum “profit is the only goal of business”, transformed into
“maximizing shareholder values (as measured by the market price of shares) is the only goal of
business.” From there, comes the long, incredible, but apparently innocuous leap: “maximizing share
prices is the goal of financial reporting regulators/standard-setters.” This leap has two important
dimensions. Shareholders are not the only group in society whose interests regulators and standard are
charged with protecting. Second, informing shareholders so they can make better investment decisions
is not the same thing as financial reporting that will increase stock prices and returns.³

2.4 Produce data with desirable statistical attributes

Financial reports that furnish data of specified statistical attributes is a fourth approach to defining the
meaning of better financial reports. Perhaps the best known of such proposals is to consider a larger
correlation between accounting income or returns and stock market returns a measure of better
financial reporting under the catchy but misleading label of “value relevant” reporting.⁴

It has been suggested on various occasions that financial reports include consolidation of controlled
entities, separate business and geographical segments, quarterly results, and disclosures of financial
instruments, off-balance sheet financing, uncertainties, and separate core from non-core businesses. In
1994 AICPA’s Jenkins Committee recommended that reports include not only financial but also non-
financial information. After the practice and the legal regime had long discouraged inclusion of forward
looking information for the fear of fraud and lies, Jenkins Committee and US Congress also encouraged
inclusion of such information in corporate financial reports under safe harbor rule (i.e., no penalties if
such information subsequently turns out to be wrong or misleading). ...

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³ In the wake of financial reporting scandal at Enron in 2001, the stock price dropped from 90s to less than a dollar.
According to one estimate, Enron should have been worth about $5 at the time. Whether the shareholders lost
$85 (= 90 - 5) or $4 (= 5 - 1) is a matter of some debate. Are shareholders interested in financial reports that
accurately reflect or maximize the value of their stakes should not be, but remains, controversial.
⁴ Value relevance implies a causal direction, which may generate statistical correlation; however statistical
correlation does not imply causality.
2.6 Financial Reporting as a Ritual ("Rain Dance")

A ritual is an invariant sequence of actions performed in religious, social, organizational, and individual contexts, either without a stated purpose, or without an empirically verifiable link to their purported purpose. University commencements, tribal rain dances, visits to places of worship, shaking hands at the time of being introduced, or saying goodbye when parting company are a few examples of rituals practiced in societies across the world. According to Bell (1997) rituals may be prescribed by the traditions of a community and characterized by formalism, traditionalism, invariance, rule-governance, sacral symbolism, and performance. Skeptics about financial reporting see its practice as a ritual full of symbolism but little substance.

Some purposive activities continue through the force of habit, tradition, or superstition long after their original purpose is lost to changing circumstances or social memory. Rain dance is not assessed by whether precipitation follows; other measures such as the number of participants, beauty of the costumes, the sumptuousness of the feast that follows replace the objective criteria. Similar statements can be made about prayer.

In summary, “better” in financial reporting could be defined to mean many things: meeting specified societal or individual goals, or possessing some general qualitative or specific statistical attributes. It is difficult, even at a conceptual level, to obtain agreement of what kind of financial reports do or can meet the criteria within any one of these four classes, much less all four. Absent agreement, what can be done?

3. Possible courses of action in absence of agreement about what is better

Without broad agreement across and within its constituent groups, it is an understatement to say that the meaning of “better” in financial reporting remains far from obvious: better in what sense and for who, are unresolved issues. Such divergence in social policy is hardly unique to financial reporting; it is common to most aspects of law, regulation, and other problems of collective choice. Financial reporting includes elements of collective as well as private choice. Looking at aspects of economic life outside accounting may help us.

Analytical derivation of solutions to problems of collective choice is difficult in most circumstances for the reasons similar to those outlined for the problem of selecting criteria for “better” accounting in the preceding section. Process is an alternative to criteria. Perhaps it is possible to develop a socially acceptable process for defining and developing financial reporting in the hope that its outcome will be an improvement, at least by some broad subjective judgments if not by criteria-based analysis.
4. Processes for Collective Choice in Accounting

Given the difficulties of choosing and applying a priori social welfare criteria, human societies have developed and employed a variety of social choice mechanisms to solve the problem. While written standards issued by a regulatory body are the most frequently employed and analyzed mechanism in the domain of financial reporting, they are neither the only nor necessarily the best mechanism for all aspects of financial reporting. At the outset, it is useful to consider the characteristics of the available alternatives. I classify them into eight broad categories—common law, popular vote or referendum, legislative or statutory, judicial, administrative-regulation, self-regulation, and market—recognizing that in practice, two or more may be used in parallel.

4.1 Common Law

The common law, like language and other social norms, emerges from the grass roots. It is the most diffused of collective choice mechanisms with minimum role for a centralized authority. The process of such emergence is not well-understood, and it does conform to the demands of a defined time table. It can only deal with matters of broad principle that do not call for fine-grained distinctions and technical details beyond the capacity of non-experts. Paciolo’s text written in the fifteenth century codified the prevailing accounting practices of Italian merchants of his time. In this sense, the book can be seen as an attempt to capture the common law” of accounting. Indeed, the phrase “generally accepted accounting principles” reflects the common law origins of accounting and financial reporting.

Financial reporting was largely left to be served by this common law approach until the number and size of publicly owned business enterprises grew to account for a significant proportion of economic activity. Rapid growth of larger complex publicly-traded organizations in manufacturing, transportation, utility, and service industries placed additional demands on financial reporting systems that could not easily be met by the common law approach; in the twentieth century, the GAAP label was capitalized and appropriated by corporate bodies created with legal authority to make and impose top-down rules on reporting entities.

4.2 Popular Vote or Referendum

In making collective choice by popular vote or a referendum, individual citizen have the chance to indicate their preference directly. Referenda can work reasonably well as social decision mechanisms when the citizens can be presented with just two, or no more than a few, simple, ready-to-understand alternatives such as “X or Y” or “Yes or No”. Permitting legalized gambling, sale of alcoholic beverages, and caps on real estate taxes are example such issues amenable to this form of collective decision-making. As the number and complexity of alternatives increases, efficacy of popular vote is diminished because most citizens do not have the knowledge base to make an informed choice, and formulation of alternatives presented to the citizens itself becomes an important part of decision making that cannot be handled by referenda. Moreover, when the voters do not comprehend the implications of the

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5 Also see Sunder (1988).
collective choice at stake, they become more susceptible to suggestions, advertising, and demagoguery. It is not surprising that financial reporting choices are not made by this method.

4.3 Statutes and Legislation

We have already discussed common law; statutes are the other part of law. Statutes are a result of top-down decisions of the ruling dispensation. In democratic systems, formulation, debate, and approval of statutes is entrusted to a legislature consisting of representatives elected by constituents to speak on the former’s behalf. Whether the legislature passes a statute depends on the support for such action from a sufficient number of its members, depending on its rules of procedure. If it operates of a majority rule, for example, it can take no action unless one of the proposals on the table gains majority support. But “no legislative action” is also a choice, which amounts to leaving the status quo undisturbed.

There is no restriction on members of the legislature arguing for proposals that favor them or their constituents, and most of them are not shy to do so. One advantage legislative decision making is that the conflicting interests are articulated, debated, and bargained on, during the process. Little of the reasoning and motivations behind conflicting positions is left hidden under the rug, and all sides, not just two, get the chance to air their views on the issues at hand. Given the broad responsibilities of legislatures across all issues in political domain, few legislators can be expected to have the time, ability, or inclination to become knowledgeable about technically complex issues such as financial reporting. Even when legislatures engage with such issues, they rarely understand the issues, and tend to leave the details to staff, and the results often leave much to be desired. In the 1990s, US Congress got involved in accounting for executive stock options under lobbying pressures from the Silicon Valley, and it took many years for US financial reporting to recover from that intervention. French government’s intervention with the International Accounting Standards Board in the wake of accounting problems at Societe Generale had similar effects. The title of Romano’s (2005) paper “Sarbanes-Oxley Act and the Making of Quack Corporate Governance” is an indication of serious doubts about the wisdom of legislative intervention in the specifics of financial reporting.

4.4 Courts

Unlike the legislatures where the members are free to argue for their own or constituent interests when they deliberate and debate the statutes, judges in courts must take a neutral stance. While judges also are under pressure of the arguments advanced by the two sides before them, they must decide on the basis of common or statutory law, and not on their personal preferences. Any obvious violation of this judicial norm carries significant risk of reversal on appeal in higher courts, and loss of public esteem for the court. This sharp contrast with the legislators who may consider multiple alternatives, courts typically have two sides before them, and must decide one way or the other; they cannot punt. Courts can deliberate on a case for weeks or months, and have the benefit of expert advice in deciding a case.
Judicial and legislative mechanisms rarely stand alone and are frequently accompanied by bureaucratic support. However, some standard-setting mechanisms are almost purely bureaucratic. I return later to some problems of bureaucratic mechanisms.

Spacek (1958) headed the major accounting firm of Arthur Andersen & Co. when he proposed that financial reporting disputes be resolved in a specialized accounting court. Such a court would have developed the expertise to handle the finer points and technical details that might be lost in a general court. Such a court might be able to use common law to make judgments about whether the financial reports under scrutiny present a “true and fair” picture of the status and the performance of the relevant entity in a manner analogous to determination of “guilty beyond reasonable doubt” in criminal cases. Creation of such courts will help reduce the rapidly expanding administrative and regulatory burdens of making and enforcing rules. Spacek’s proposal has not received much traction in the accounting, business or regulatory communities over half-a-century. Administrative and regulatory approaches to addressing problems of financial reporting have remained and grown in their dominance.

4.5 Administrative and Regulatory Agency

In 1930s, US Congress handed the responsibility for regulation of publicly traded companies’ financial reporting to the newly created Securities and Exchange Commission. Under the US system, once appointed, commissioners of a regulatory agency exercise a great deal of independence from the administrative apparatus of the government during their term of office. These agencies are answerable to US Congress for the laws they are charged with implementing. Under this administrative arrangement, we have seen effective regulation (e.g., of insider trading), innovation and experimentation with regulatory methods (e.g., accounting for inflation and for oil and gas exploration), as well as dismal failure to maintain the quality of financial reports (e.g., Enron, WorldCom, GlobalCrossing, etc.).

Administrative approach to regulation appears to have worked well when the agencies are allowed to, and in fact exercise their discretionary powers and judgment in public interest. For example, the refusal of the SEC to define insider trading beyond “trading on non-public information” has enabled it a measure of success in prosecuting many cases. The agency has been under constant pressure to further define “trading on non-public information”. Had it yielded to that pressure, as did regulators in Japan who wrote down the definition in several pages, SEC would also have failed to go after wrong doers who can use such definitions as a road map for evasion.

This points to the basic dilemma regulators face. If they write down only general principles, they allow themselves room for exercise of their judgment to bring enforcement actions when they see a violation of the principles. The defense complains about the lack of specificity in the principles, and calls for clarification (or “guidance”, a frequently used term in the context of financial reporting). Every clarification shifts principles towards in the direction of rules, and opens up new loopholes in regulation. Detail and complexity gradually inches up on demand from the regulatees, making it progressively difficult for the agency to exercise judgment on general principles of reporting. The failure to follow this
process attracts charges of arbitrariness and absence of due process, which are difficult to rebut in a democratic polity.

4.6 Self-Regulation

Self-regulation allows a profession or industry to create and operate its own system of regulating the behavior of its members and the quality of their goods or services. Such organizations exist across many parts of the economy to set standards, monitor quality and performance, and take punitive actions when deemed necessary. Self-regulatory organizations tend to be more effective in creating coordination standards because they tend to be largely self-enforcing. If the Association of American Railroads were to set a standard for rails to be placed one meter apart, it is in the interest of virtually all railroads to conform to the standard. The same is not true of quality standards, because individuals have incentives to cut corners by free riding on industry reputation, especially if the quality is not easily observable to their customers. For this reason, self-regulatory organizations tend to be concentrated in coordination work, and government standards play a stronger role where quality is concerned (see Jamal and Sunder 2014).

Over its eighty-year history, the US SEC has encouraged creation of self-regulatory organizations in financial reporting and relied on them to a significant degree. In its early years, the SEC let the American Institute of Certified Public Accountants—a professional association—set the financial reporting standards through its committees such as the Committee on Accounting Procedure and the Accounting Principles Board. In 1972, the APB was replaced by another self-regulatory organization (Financial Accounting Foundation-Financial Accounting Standards Board) with broader representation from outside the accounting profession which nevertheless retained majority of seats in the FASB. These organizations worked closely with SEC’s Chief Accountant, and rarely issued rules without pre-approval by the SEC staff. Under this arrangement, following the preparers’ constant demands for clarification, the body of written rules that are now supposed to constitute the “Generally Accepted Accounting Principles” has grown to some tens of thousands of pages.

4.7 Markets

In absence of externalities and with sufficient competition, markets offer an efficient solution for the problem of producing and allocating private goods. Information contained in financial reporting has both the zero marginal cost and the non-excludability properties of public goods. The cost of producing these reports includes two parts. The first is the out-of-pocket cost of preparing the reports from the transactions database (which the firm must maintain in any case for managing its operations and exercising internal control). Perhaps a larger cost takes the more difficult to quantify forms of regulatory compliance, and the changes in behavior of management induced by financial reporting regulations. Consideration of these public good aspects of financial reporting information points to addressing it as a collective and not as a private choice problem.

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6 Private goods are defined in contradistinction to public goods (zero marginal cost of producing additional units and non-excludability of the non-payers from the benefits).
As already discussed, handing the problem over to one of the collective choice mechanisms does not resolve the difficulties of identifying better reporting methods. However, one can conceive of a system of competition among alternative sets of rules by which markets operate (e.g., stock exchanges, environmental regulations, educational systems, etc.). These alternative sets can be made into private goods by demanding a fee or tax from those who choose to be participate in them.

As we move from common law towards bureaucratic mechanism, fewer people are directly involved in making decisions, more of the power of an organized state is brought to enforce the decisions, decisions can be made and enforced more expeditiously, and the chances of making serious errors increase. Historically, this has been the direction of change in the United States. In the recent decades, the European Unions appears to have followed. Given the prevailing level of dissatisfaction with the current financial reporting regime, we need to consider where we might have gone wrong in conceptualizing the meaning of better financial reporting, and means of achieve that end.

5. **What is missing in the meaning of better financial reporting**

   - Stability
   - Emergent
   - Robust to financial engineering (Sorites Paradox)
   - Learning systems
   - Rooted in business and legal environment
   - Recognize endogeneity of transactions complexity
   - Active engagement of academics with issues and debates

6. **A balanced regime for better financial reporting**

   - Regulation and standards vs. culture and social norms
   - Specificity vs. purposefully ambiguity
   - Threshold vs. continuous approaches
   - Authority vs. competition
   - Privacy vs. open transactions database (Sorter’s “events” approach)
   - Confidence in designed social systems vs. some humility

7. Concluding remarks

   The setting of standards is not a mere technical matter. Technical expertise is of course important to setting of standards but it is not sufficient. Standards, in accounting as in other areas, involve
consideration of social efficiency (which is a technical matter) and of distribution of wealth (which is a political matter). As in all political matters, people can differ without any one being wrong. The quasi-judicial structure of the FASB/IASB, combined with a large technical staff, has tended to give a technical flavor to its task and for many years the FASB remained reluctant to recognize the political (i.e., distributional) aspects of its charge. A quasi-legislative system will shift the emphasis toward the political part without damaging the technical part. The members of the new structure will still be required to have a high level of technical competence as in the past.

Appointment of disinterested parties (e.g., accounting professors), who presumably have no identifiable political interests as a class in setting of accounting standards, to a standard-setting body tends to detract from the political aspects of its task. They need not be voting members of such a quasi-legislative structure and could continue, as in the past, to provide valuable advisory and technical support as members of the staff.

No standard is indispensable. People can and do live without standards of many types. Absence of a standard is rarely catastrophic; people adjust their behavior to the status quo. On the contrary, issuance of a standard can be a catastrophe. The performance of a standardization organization can no more be measured by the number of pages of standards issued than the success of a parliament can be judged by the number of laws passed. There is no connection, not even an approximate one, between the two. Is an active parliament a good parliament? Is an active standard setter a good standard setter? We must get rid of the habit of carrying the positive image of “proactive” behavior from the personal to this institutional domain.

Refusal of a standard-setting body to issue aggressive standards means delay in standardizing accounting for newer types of business transactions and phenomena. It is no more reasonable to expect that accountants can instantaneously come up with efficient standards for newer types of business transactions than that physicians can come up with a cure for AIDS or that engineers can fix the space shuttle overnight. The imperfection of our knowledge generates the necessity to conduct field testing of a variety of solutions to new problems. Forcibly speeding up the process imposes the large costs of making mistakes, changes, and resultant confusion in financial markets. Accountants who worry that the Securities and Exchange Commission may not accept a slower pace of response to new issues only need to remember, and remind the SEC of, the reserve recognition accounting.

No matter what institutional mechanism we devise to set accounting standards, our ability to identify socially superior solutions is, and will remain, limited and imperfect due to several reasons I discussed earlier. We cannot observe other people’s preferences; people’s preferences depend on what they know and their past experience, which change continually. When new solutions or standards are implemented, people adjust their behavior to the new situation. Therefore, an understanding or observation of how people change their behavior in response to new standards is indispensable to devising socially efficient standards. The more aggressive a standard is, the less likely it is that we can completely understand its consequences. Perhaps the practice-based orientation of accounting standards widely used in Canada and in other countries of the world does make sense after all; a shift in emphasis from aggressive toward more practice-based standards should be considered. Given the
fourteen-year experience of the FASB going out on a limb with aggressive standards, some modesty with respect to our ability to devise new accounting methods which are socially preferred standards may not be out of place.

7. References


Figure 1: A Matter of Perspective: Ground-Level, Aerial, and “Blue Marble” Perspectives

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<th>Ground Level</th>
<th>Aerial Perspective</th>
<th>The Blue Marble</th>
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