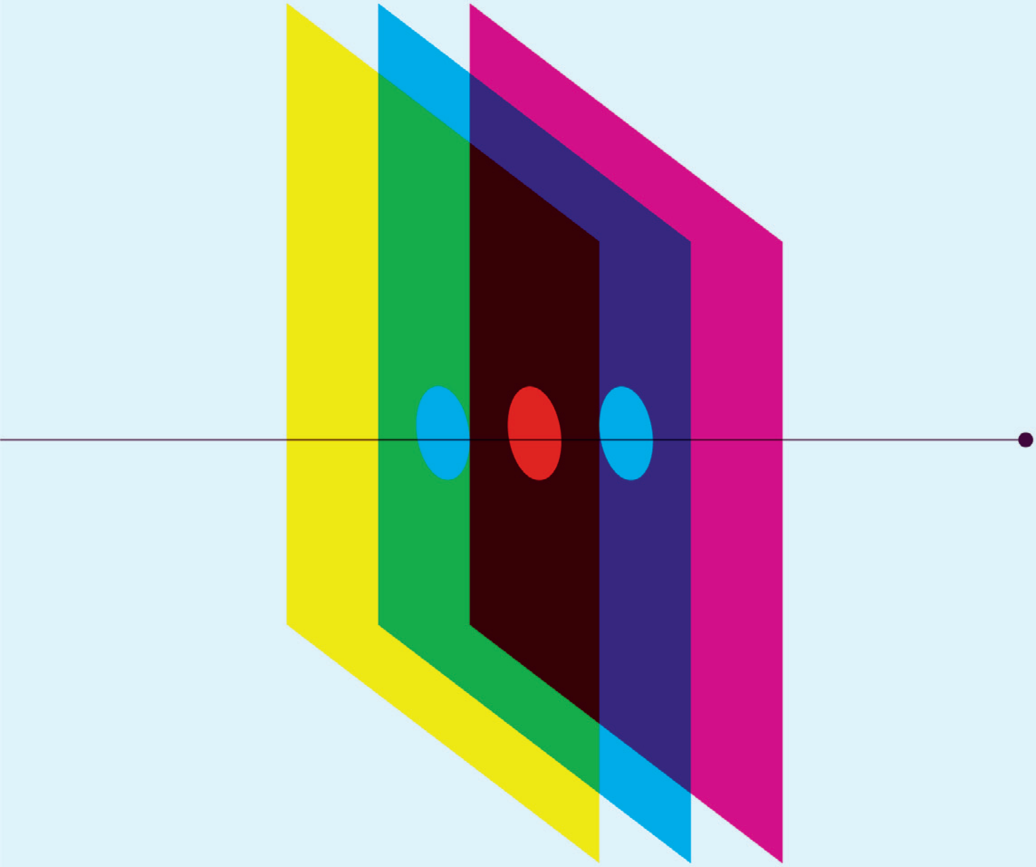

A Postmodern Accounting Theory

An Institutional Approach

Gaétan Breton

A POSTMODERN ACCOUNTING THEORY

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A POSTMODERN ACCOUNTING THEORY: AN INSTITUTIONAL APPROACH

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About the Author

Gaétan Breton is author or co-author of over a dozen books, mostly essays, and over 30 academic articles. He graduated from the City University of London and is currently a Professor of Accounting at Université du Québec à Montréal. In the last 15 years he has concentrated his teaching at the graduate level and supervised many Masters and PhD students. He is also deeply invested in the life of his community, having served as treasurer and councilor for many not-for-profit organizations.

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Foreword

This book aims to break with tradition in many ways. Firstly, we want to submit the accounting activity to the standards established in the human sciences. Consequently, the standardization process will not be presented as a form of theorization and the books of standards will not be presented as accounting theories. Our attitude constitutes a major rupture with the traditional vision.

This traditional vision based on an intense confusion leads to strange ways of presenting the research done since the 1960s. We want to discuss these research as products of the institution of accounting and as representing different aspects of the accounting theory. The body of research has some specific tendencies; for instance, the massive use of mathematics for two reasons: firstly, to establish a rupture with the traditional "research," which was more practitioners' discussions than "scientific" investigation, and secondly, to topple accounting research on the side of the "pure" sciences following the research in finance and economics. Economics occupies a particular place in the general picture of the academic disciplines. It is not really included among the human sciences and surely not among the natural sciences. Some people consider that it can be no science at all. Considering the crucial influence of economics on the development of accounting, we argue that the students in accounting have the right to be exposed to the discussion in its most actual state.

To do so we adopt a postmodern position, which is in fact an attitude. The most important leitmotif we keep from this position is to doubt every dogma included in the traditional accounting theory handbooks. This doubt will lead to discussing the situations and the concepts leaving the students with the possibility of making their own choices. We want to enlighten their choices instead of indoctrinating it.

Here comes the second position from our postmodern approach, which is to consider that there is no unique good answer to one question but many possible answers that are socially discriminated by whoever holds the power in the institutions.

This book is addressed to accounting students at undergraduate and graduate levels. We refuse to imprison undergraduate students in a compulsive vision of learning, transforming them into machines only able to repeat infinite lists of details. Graham Stacey, head of research at Price Waterhouse London, told us once about the graduates in accounting: *they are not educated, they are trained*. At the end of their program they will be specialists of a profession in society but, in the actual state of the academic system, they may have never thought about their role in this society except for claiming their protected field of intervention; although for others they are furiously advocating the "free market."

In this spirit, the questions at the end of the chapters may be viewed more as discussion topics than questions with a specific answer. Obviously, they are related to the content of the chapters, but they may sometimes necessitate other readings to be answered properly, which means with an open state of mind. Although everyone studying accounting may be confronted with such questions or topics, graduate students may be more prone or able to provide more complete answers.

Finally, as the students-readers will understand later, we take a constructivist point of view contrary to the implicit positivist one behind the classical accounting theory handbooks. We also start with the concept that any institution is a discursive object. Being discursive doesn't imply that it does not exist for real, it is only another form of existence. These are the bases on which we build our accounting theory which is not made of standards and any pretentions about some supposed "laws" driving the markets.

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Chapter 1

Introduction

Postmodernism is firstly forced to apply its principles to itself. Then, as the theory of relativity cannot be absolutely relative, the main principle of postmodernism to relativize and doubt every statement can hardly produce a definition of itself that would be "definitive." Therefore, this "school of thought" will have problems to express its identity which would be to form no school of thought. Seen like that, postmodernism seems to have caught the quintessence of the academic spirit.

Deconstruction is the most important attitude in this current period, even without the task of reconstructing after:

> *The postmodern condition of fragmentation and simulation makes coherence problematic.* (Boje, 2001b, p. 5)

Obviously, the idea and even the project of doubting everything are known at least since Descartes and Plato (Major, 2012). These authors had also a project of reconstructing the world after deconstruction. However, postmodernism can leave pieces on the floor of history as Picasso was leaving pieces of bodies disseminated in his paintings. The deconstructed text appears like the organization in the agency theory: a nexus of relations escaping to ordinary hierarchies and even to the basic rules of language; it is everywhere and nowhere at the same time and cannot anymore be physically localized and assigned to a specific source of power. This accounting theory handbook recognizes the discursive nature of accounting and therefore its ethereal character.

This book aims to distinguish clearly the scientific and the standard-setting processes and apply the principles recognized in other social sciences as a basis to establish an accounting theory. In consequence we have to remember that the social activity comes before the theory and not the contrary.

Then, we will discuss the possible basic constituents of the theory of accounting. Such constituents must be derived through considering accounting as an object of knowledge and then studying it in interaction with other objects. We will consider accounting as an institution, implying the presence of participants and objects. Some of these are accountants, shareholders, users of accounting numbers, passive receivers of accounting reports, governments, governmental agencies, and also reports, books (both textbooks and registers kept in

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organizations), annual reports, etc. These peoples and objects are evolving within the boundaries established by the surrounding society. Therefore, as any social object, accounting must firstly be studied from a sociological point of view.

When accounting reports are requested, people in the organization may be tempted to use it as an instrument to produce some impressions. Therefore, there is a psychological effect of accounting reports on those preparing and receiving them. Moreover, these reports are said to be input in the decision-making process. But, there is never any explanation on how decisions are made and on the kind of accounting information able to support this process. In this book, we will consider both aspects. How accounting reports can modify the behavior of those preparing it or part of it, and the effects of the reports on those receiving it. This latter part includes a study of the state of the knowledge about the decision-making process.

Then, we will study the communicational aspect of accounting reports. We will compare the methods available to study written productions and see what we can say of accounting reports as communication devices. In most accounting theory books, the usefulness of an accounting report is taken for granted and the informational quality of the reports is presented as a function of its length. That was also often the case in accounting research. The disclosure had been measured from the space occupied in the annual report, noticeably for social and environmental disclosure. The communicational aspect of accounting is a part of its psychological aspect considering how the financial statements are constructed to produce specific effects on the receivers.

Traditional accounting theory handbooks have problems with the treatment of research. The reason is dual. Firstly, the obsession of trying to include the standard-setting activity in the accounting theory places them in an awkward situation toward research. The most recent books on accounting theory do not correct this problem; they add the researches along the standard-setting as if it was two aspects of the same process. As in any other discipline, the research is supposed to build a constantly evolving theory; which is greatly incompatible with including the standardization process and keeping the traditional financial statements as the canvas on which the accounting information is always conceived. Even Scott (2003) ignores what to do with accounting research.

> *A book about accounting theory must inevitably draw on accounting research, much of which is contained in academic journals. There are two complementary ways that we can view the role of research. The first is to consider its effects on accounting practice. (…) The essence of this approach is that investors should be supplied with information to help them make good investment decisions (…).*
>
> *Yet, this increase in disclosure did not "just happen." It (…) is based on fundamental research into the theory of investor decision-making and the theory of capital markets, which have guided the accountant in what information is useful (…).*

> *Independently of whether it affects current practice, however, there is a second important view of the role of research. This is to improve our understanding of the accounting environment (…)*. (Scott, 2003, pp. 6–7)

Scott talks about the role of research, although placing research in a corner. The role of research in accounting theory is the same as in sociology or psychology – to elaborate theories explaining and predicting "reality." Scott's position constitutes an acceptation of all that had been called accounting theory in the past. Then he uses as an example the research on capital markets that had been derived from the basic conceptions of economics. Finally, he invokes researches about "conflicts" and proposes the discussions around the agency model to illustrate that. These are the two focal lines in Scott's book, the *adverse selection*, which might be an effect of a poor provision of information and the *moral hazard*, which is reputed to come from an asymmetry of information. This vision gives accounting a crucial and traditional role as both the major problems identified are informational in nature.

Accounting has remained surprisingly stable across times. A reading of the book by Pacioli (1494) shows that little has changed for centuries. The complexification of business financing and structuring had increased the length of the notes but had little fundamental effects on the structure of the financial statements. For instance, the fundamental assets of the new economy are still ignored in large part by the accounting reports in the name of the difficulty to measure it.

In consequence, our book will be totally different from its predecessors although we are far from considering it as definitive. We will start by discussing the concepts of theory and school of thought. Previous books, symptomatically, take one of two options: they may take these notions for granted or propose many explanations while proposing no real conclusion. Here, we will clearly take some positions and go forward based on it. After having clarified these concepts we will analyze, although quite rapidly, the preceding accounting theory handbooks, mainly to determine the limits of their conception of a theory. In a postmodern spirit, we will also clarify and criticize their epistemological position.

Then, after having established what is a theory and looking at the definitions provided by our predecessor, we will define the second term of our main title: accounting. Accounting is strangely seldom defined in accounting theory books. We will provide a definition that will allow us to go further in associating both terms: theory and accounting.

Then, we will look at the main environment of accounting – the firm – and this will lead us to the real principal environment of the accounting activity and of the firm itself, the State and the Society.

From that, we may be able to propose a first aspect of the accounting theory. This aspect will be sociological. Then, we will explore the psychological aspect including all the decisional aspects related to the use of accounting reports or accounting information. At this point, we may try to put together the pieces of what will be an accounting theory.

The following section inventories the methods to be used in analyzing accounting documents including an analysis of the manipulations and the distortions, voluntary or not, affecting the quality of the information. The behavior of the producers of this "information" and the attitudes of the "users" are part of the theory.

SECTION 1: THEORIES AND ACCOUNTING

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Chapter 2

Theories and Schools of Thought

The accounting literature do not define clearly the concept of theory. For a long time accountants have considered that the book of standards constituted the theory of accounting. Then they have made distinctions between the standard itself and some principles that are reputed to be behind the choices of the standard-settlers: relevance, reliability, verifiability, etc.

> *A theory is a systematic statement of the rules or principles which underlie or govern a set of phenomena. A theory may be viewed as a framework permitting the organization of ideas, the explanation of phenomena, and the prediction of future behaviour.*
>
> *Accounting theory is that branch of accounting which consists of the systematic statement of principles and methodology, as distinct from practice. Thus, the rule of conservatism belongs to the subject of accounting theory; the practice of providing for future losses from current doubtful receivables, being a question of practice, does not.* (Most, 1982, p. 55)

The first section is widely accepted outside the accounting domain. A theory explains and predicts is a sentence we can find in many books, for instance Gay and Diebl (1992). The next section does not flow from the first part. Conservatism is a choice, not a rule explaining or predicting. However, conservatism is an interesting phenomenon to be studied as an object by an accounting science.

In the US, there had been a lot of discussion around the *conceptual framework,* which can be considered a good thing as long as we understand that it is not theoretical or even conceptual. In fact, the framework would be better called political. The Trueblood Committee made plenty of consultations about the objectives of the financial statements (Belkaoui, 1992). We can notice that the process of creating a Committee and sending it on the road to consult different groups or persons is more like a political approach than a scientific one.

Their report concluded that:

> *The basic objective of financial statements is to provide information on which to base economic decisions.* (Belkaoui, 1992, p. 183)

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But, this is done without any real investigation or integration of any research on the decision-making process. They must also provide a list of the users. We have the habitual list ending by the government and the society. Nobody ever asked what might be the information needs of those groups. If we read the introduction of the International Financial Reporting Standards (IFRS), we will see that they settle the question saying that the economic aspect being the most important also for the society what satisfies the investors' needs will be enough for the other users.

> *Although all the needs for information of these users cannot be satisfied by financial statements, there are needs that are common to all users. As the investors are suppliers of risky capital to the entity, the provision of financial statements responding to their needs will satisfy equally to most needs of other users susceptible to be satisfied by financial statements.* (IASB, 2006, p. 37) (Our translation)

Therefore the decision has been taken. The information needs of other groups have to align with those of the investors as they are providing the risky capital and that is clearly the most important element. Nobody asked what the other groups were bringing. A reading of Hill and Jones (1992) may have changed their vision. There is not only money invested in a firm and, among money, there is not only direct money. The society has invested education, health of people (workers), and many public infrastructures (Sen, 2003) constituting indirect investment. The need of the government for information to assess the extent to which the firm has fulfilled its mandate cannot be subsidiaried to the information given to the shareholders. We see already that it will be a long fight between public versus private interests. The standards being done mostly by some private institution, although on the behalf of the public authority over professions, incorporate uniquely private investments in money and private needs of information.

Governments have the power to require this information.

> *Any social institution - and business is no exception - operates in society via a social contract, expressed or implied, whereby its survival and growth are based on:*
>
> *(1) the delivery of some socially desirable ends to society in general, and*
>
> *(2) the distribution of economic, social, political benefits to groups from which it derives its power.* (Shocker & Sethi, 1973, p. 97)

The firm is a social institution. This important role must be controlled, which is, a primordial function of accounting. If the institution is not fulfilling its mandate, it may be revoked.

> *In a dynamic society, neither the sources of institutional power nor the needs for its services are permanent. Therefore an institution*