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Imagined Worlds of Accounting

Shyam Sunder

Abstract

Science, engineering, and all other learned disciplines, as well as our socio-political-economic organizations are artifacts—results of our imagination and ingenuity. Modern corporation—a marvel of organizational engineering—would not be possible without imagination. To run organizations, in the face of the centrifugal forces of divergent self-interest and inherently dispersed information, we need accounting. Accounting, too, is an artifact that arose from human imagination, as a precursor of, or contemporaneously with, mathematics, writing and the civilization itself. We explore the case for imagination in our discipline with respect to its environment, scholarship and instruction. Specifically, accounting scholarship includes examination not only of the way things were and are, but also of how they can be. Why should we imagine alternate scenarios, instead of simply waiting for changes to occur, or being forced upon us? We must do so, because imagination is necessary to bring about innovation in practice and in institutions, so our children might live in a better world.

KEYWORDS: accounting theory, accounting regulation, accounting education, accounting profession

JEL Classification Codes: M40

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You see things; and you say "Why?" But I dream things that never were; and I say "Why not?"

George Bernard Shaw¹

"(t)he historic role of the scientist is to do the unthinkable, to overturn cherished beliefs, and to kill gods."

J. B. S. Haldane²

Human beings are unique among the thousands of species on this earth. We have two special gifts not shared by other species—a sense of humor and imagination. It is difficult to be sure about humor, but we do know that much of human civilization and its accomplishments—all eight wonders of the ancient world, as well as the modern miracles of airplanes, computers, cell phones, space exploration, and sewage systems, indeed all science and engineering, are results of our imagination. None would have been possible had someone not dared to imagine them into existence.

Literature imagines alternative worlds for living just as science explores alternative conceptualizations of the physical world. In his book, *Imagined Worlds* physicist Freeman J. Dyson merges story-telling with science to offer a compelling vision of how the biological and information sciences are reshaping the future of humanity. I have paraphrased the title of Dyson (1997)'s book for this essay.

Beyond science and engineering, all learned disciplines, and our socio-political-economic organizations are also artifacts because they are the results of our imagination. Modern corporation—a marvel of organizational engineering—would not be possible without imagination. To run organizations, in the face of the centrifugal forces of divergent self-interest and inherently dispersed information, we need accounting, again a remarkable achievement of human imagination. William Halo, a scholar of Babylonian Studies at Yale, reports evidence of double-entry bookkeeping in cuneiform clay tablets from the 22nd century BC, some 3,700 years before Friar Luca Pacioli wrote his own manual documenting the prevailing Italian practice. Accounting, too, is an artifact that arose from human imagination, as a precursor of, or contemporaneously with, mathematics, writing and the civilization itself.

If imagination is the wellspring of our discipline and all human advancement, it may be of some interest to explore the case for imagination in our discipline today and in the future. We can think of accounting scholarship as examination not only of the way things were and are, but also of how they can be.

¹ The serpent says these words to Eve.

² Quoted by Dyson (1998: 97).

What could the alternative scenarios for the futures be? Prediction and social engineering are not the only motivations for asking such a question. Thinking about the possible alternatives to the current institutions of accounting and auditing is essential if our world is to change. Thinking about the possible consequences of these alternatives is essential if that change is to be for the better. Imagination must be an essential element of accounting scholarship and instruction. Let us explore this dimension of our work.

While innovation is valued in scholarship, tradition is revered in practice. Stability of institutions has certain meaning in itself; stability also yields time series of data which are critical for comparative research endeavors. Why should we imagine alternate scenarios, instead of simply waiting for changes to occur, or being forced upon us? We must do so, because imagination is necessary to adjust to changes in our environment, and to bring about innovation in practice and in institutions, so our children might live in a better world.

1. Our Environment

Let us start with our environment. Since the introduction of the federal securities laws some 75 years ago, the burden of defining what is acceptable accounting practice has shifted gradually, but inexorably, toward formal rules and standards, enforced by the threat of punishment by the power of authority. Generally accepted accounting principles, or GAAP, a concept that originated as a social norm, has been appropriated to describe regulations and standards. Imagine how generally imposed accounting principles came to carry the label of generally accepted, presenting us with new wine in vintage bottle.

Can we imagine a world in which we strive to achieve a better balance between social norms of the business and accounting community, enforced by the social networks and sanctions on the one hand, and formal standards and rules enforced by the power of punishment on the other? We know that social norms alone tend to break down when community is large and stakes are high. But the same is true of regulations and laws. The solution may lie, not at one end of the spectrum or the other, but in some judicious combination of the two. Imagine, trying to achieve a better balance than we now have.

If it sounds implausible in accounting, let us think about law. If one is accused of a crime, and the case goes to trial, at the end of the proceedings, the judge turns to the jury and asks if they think the accused to be guilty beyond a reasonable doubt. The jury might ask the judge about the threshold for reasonable doubt. Should it be one, three, five, or 20 percent? But the judge responds by asking the members of the jury to use their own social norm and judgment to make even the life-and-death decision for the accused. What if the judge were from accounting? The answer might be three percent, and the result would be

thousands of special purpose entities that Andrew Fastow set up for Enron while serving as its chief financial officer.

Imagine a world where accountants have a better understanding of how law works and where Congress and the courts leave the ultimate judgments to the common sense of lay juries, unversed in the intricacies of law. Can we imagine a world where accountants place similar constraints on themselves in writing down the rules? Imagine a realization that written rules and regulations, and their enforcement, no matter how detailed, industrious and judicious, cannot do it all, without the help of vaguely defined and only approximately understood social norms and social sanctions. “Making the rules clear” appears to be an unimpeachable endeavor; until they become “road maps for evasion” in the language of law.

It is often argued that auditors need detailed rules because it is difficult for them to resist client pressures without them. Giving in to whatever the customer wants is not the hallmark of a profession. Imagine a world in which the profession recognizes that a large part of the compensation its members receive is for exercise of their professional judgment, and not merely for operating a search engine on a rule book. The smaller the role of judgment in a profession, the lower is its compensation. Imagine the consequences of this recognition. Demanding more detailed standards from Norwalk or London may be convenient in the short run, but is ultimately self-destructive for the profession.

Imagine a world in which regulators stop issuing authoritative definitions of accounting terms. Being the language of business, accounting shares some fundamental characteristics with natural languages. Imagine recognizing that the usefulness of words arises from the uncertainty—the penumbra of variations of meanings—associated with words. Value of any word—“cat” or “house” or “assets”—would be lost if they could only be used for exactly identical objects. “House,” for example, is a general concept, referring to a variety of existing and not-yet-conceived-of constructions; otherwise, every design of a dwelling will require a distinct word of its own. Whether the word “house” is to be used for a particular construction (e.g., 55 Hillhouse Avenue, New Haven, CT) must necessarily remain a matter of judgment of speakers. This centrality of judgment and variation in usage is the essence of natural languages. When we try to rid the language of ambiguity and variations in meaning, we get something like Esperanto—a nineteenth century constructed language intended to become the universal language of the world. Since it was based on a flawed understanding of how we use languages, it was dead on arrival. Imagine learning from that experience, instead of repeating that failed experiment in accounting.

Imagine recognizing that the value of the Oxford English Dictionary arises from its encyclopedic collection of the various ways in which a word has been used, not in recommending, nor enforcing the opinions of its editors. Variability

and dynamics of meaning is the source of vitality of a language. The power of English derives, not from authority, but from the freedom it permits us to communicate. Many natural languages have been, and some continue to be, strangled by the over-jealous advocates of their purity, determined to force uniformity of usage. No language, accounting included, can flourish under the straight jacket of punitive authority of state.

Imagine recognizing that accounting as a part of complex social phenomena. The tendency to set standards enforceable through the punitive power of the state is rooted in the Cartesian world view. This perspective presumes that we have enough rational understanding of the world and enough knowledge to be able to design social structures to achieve the desired ends. There is no evidence, especially in accounting, that our existing or potential knowledge justifies this predominance of the Cartesian view of the world of business and accounting.

What if, as an alternative to this command-and-control perspective, we imagine a Darwinian world where complex phenomena emerge through human creativity, experimentation, unpredictable events and their poorly understood interactions as Spencer visualized? Hayek pointed out that the information in our economy is inherently dispersed. It is not possible for any centralized authority—no matter how wise and benign their intent—to know and design social or biological systems to attain specified goals.

After a quarter century of being ignored, Hayek's perspective gained attention, and the debate on the ineffectiveness of central planning was settled. By trying to standardize accounting from the top, using the command-and-control approach, must accounting refuse to learn from the shortcomings of central planning? Must we lose another hundred years in making mistakes we can call our own, before we learn? Imagine the advantages to accounting from learning from the mistakes of others, and achieve a judicious combination of design and emergence approaches.

In his address to the American Accounting Association in 2006, Floyd Norris talked about the complexity of FAS 133 and the tendency to ignore that compendium of barely understandable, and rarely understood rules. Why is this standard so complex? It is difficult to surprise one's own children because they read and understand their parents all too well. The reason it is so difficult for regulators to tame the derivatives monster is because many if not most of these instruments are the offspring of accounting rules, designed by financial engineers to get around the existing constraints imposed by the standards. Imagine, the consequences of continuing to play this game between regulators taking a few years to devise new rules and the financial engineers taking a few minutes to devise new derivatives and lease contracts to get around the intent of the fresh regulations. Imagine how much effort and suffering could be saved if we simply

recognized that ignoring the structure of the game between regulators and the reporting clients is a losing game for the former.

Imagine letting reporting clients have more rather than fewer accounting methods to choose from. Will the resulting financial reports tell us more or less? Arguments for less have been well known. What is not so well known are Ronald Dye and Carolyn Levine's argument that by making choices, we reveal our secrets—the fewer the permissible accounting choices, the less revealing are our choices. A firm that chooses the accelerated over the straight line method of depreciation may also reveal the confidence of its managers in the future of the firm. How else could it credibly reveal such information to investors? Could it be that the uniformity dogma in financial reporting ignores the signaling value of choices that people make?

Imagine that you take away the authority of the SEC that stands behind the FASB, and the power of European Union and an increasingly number of other governments, that stands behind the IASB. In each jurisdiction, authority could choose at least two, perhaps three or four, bodies whose standards would be acceptable. Every company in the jurisdiction would be allowed to choose the set of standards it wishes to follow. These bodies would be financed exclusively by the royalties they collect from the firms which use their standards. The standard setters would effectively compete under regulatory oversight, not collude or coordinate, with each other for these royalty fees, and would be forced to make difficult choices of standards they require of the firms who choose them. Oxford English Dictionary competes with other dictionaries; so could the accounting standard setters.

Convergence may or may not emerge out of this bottom-up competition, and is not important. What will emerge are invaluable signals from the market about how investors and others value the alternatives offered by the competing rule makers. These signals become valuable guides for policy making, a function not available under the current monopoly regime. The result would be different standards, or equally important, absence of some standards.

Those who fear a race to the bottom, may rest assured that such competition occurs in many regulatory fields including stock exchanges, university accreditation, certification of ships and appliances, and bank regulation, etc. There is no evidence that competition would lead to a race to the bottom. What would be the harm in pursuing our imagination a bit further?

Imagine Joshua Ronen's proposal to let each firm buy financial misrepresentation insurance for its financial statements, leaving audit to be performed by insurance company for the sake of protecting its own interests. Imagine dusting off Leonard Spacek's old proposal to create an accounting court to settle questions about whether the financial statements fairly represent the condition and performance of the firm.

Finally, imagine a world in which we combine tax and financial reporting into one, letting firms have broad discretion over what income they wish to report both to their shareholders and to the tax collector. This would be closer to the German practice. Whatever they report to one must also be reported to the other. Perhaps we could reduce a large part of the burden of tax regulations, financial reporting standards, and dual auditing--by the IRS agents on one hand, and the independent auditors on the other, if firms had to bear the consequences of shading their reports in one direction or the other.

2. Scholarship

Second, consider accounting scholarship. Imagine a world in which scholarship is driven by the curiosity to address questions whose answers we would like to know, but don't. It would be fun to satisfy our curiosity, and thus help make it a better world.

Imagine if our doctoral programs were to attract uneasy young men and women, driven by their intense curiosity to better understand the world they live in, even if it means overturning our theories, and killing the "gods" of the field (as the famous biologist J. B. S. Haldane suggested) as well as killing their own intellectual fathers (I suggest that my students go easy on the last piece of advice). On the contrary, the current system of faculty evaluation often encourages conformity and opportunism that undermines creative potential, disruptive or innovative critique, and serious research.

Dominance of the youth in intellectual endeavors is a norm, not an exception. And it is not as far fetched as it might seem at first blush. G. H. Hardy, in his A Mathematician's Apology wrote "No mathematician should ever allow himself to forget that mathematics, more than any other art or science, is a young man's game." Tragic as Ramanujam's death at the tender age of 31 was, it was not as serious a loss in mathematics as it might be in other disciplines; few mathematicians are believed to achieve much of lasting value beyond the age of 30.

Indeed, John Muth, a graduate student at Carnegie Mellon's School of Industrial Administration, formulated his theory of rational expectations largely, it is said, as a counterpoint to Herbert Simon, the intellectual giant who had founded the school Muth was studying at, and who went on to receive the Nobel Prize in Economics in 1978. A couple of decades later Carnegie's Robert Lucas, used Muth's theory of rational expectations to model investment and money, and went on to win his own Nobel Prize.

The list of Nobel laureates earned for doctoral work is long. Imagine our own doctoral students aiming high for the big ideas, taking the risk of failure with the hope of big intellectual returns, and not simply follow the dictates of their

advisors, or do the conventional work until they get the tenure. By then, it is too late for most to change the stripes.

One of my own mentors who refused to modify his dissertation as his advisors suggested (because that would have made it wrong), and chose to forfeit the opportunity to earn a Doctor of Philosophy degree. He went on to found two prestigious schools, the Institute of Management Sciences, was the founding Editor-in-Chief of *Auditing: A Journal of Theory and Practice*, and editor of many other journals, has published over 25 books and over 500 articles in accounting and management science and economics. On the way, universities around the world have conferred over a dozen honorary doctorates on him. He has been inducted into Accounting and two other Halls of Fame, and the American Accounting Association recognized him with its Outstanding Educator Award. He has earned the John von Neumann Theory Medal, three McKinsey Foundation Awards, and American Institute of Accountants Award, but not yet a PHD. Why? Because the agency theory he proposed in the 1940s was considered hostile to the economics his advisors had been instrumental in developing. Does it matter? Imagine the passion in the heart, and the fire in the belly of such a person. Imagine such people in our programs and departments.

Imagine a world in which we disclose to our young scholars that, while we, the older folks, have the advantage of being more familiar with the literature than they are; they have the advantage of not having their thinking constrained by such knowledge. Their clean slate, and ability to think afresh, is itself a great resource that we rarely tell them about. Imagine replacing our boring lectures and required readings of our own tired articles by asking the new minds to identify and solve questions of their own. Would we all not be better off?

Imagine a world in which our scholarship includes not only doing new work, but also reading the history of thought in our discipline, and understanding the complex, mutual, often incestuous relationships among various theories.

Imagine, having our research agendas driven not so much by research method but by the question or questions we seek to answer. Imagine our academic associations organized by research questions. Imagine our journals organized by research questions instead of methods. Imagine, the sessions of our meetings and doctoral consortia organized by questions, not methods. Will this change our thinking? Will it change what we do, the conclusions we reach, and what we publish. I do not know, but would sure like to try.

In our sister disciplines such as finance, economics, marketing and operations, scholarship has had major impact on business practices. Imagine that accounting scholarship, presumably closer to a practicing profession, and better funded by the its members, also has more impact on the practice of accounting. Today, one has to think to come up with more than a few such examples.

Imagine a world in which we, the teachers of accounting, do what interests us most, whether it is the excitement and the challenge of shaping young minds and expectant lives full of promise; whether it is developing curricula, teaching materials and software to bring the knowledge and understanding of the world from whatever discipline to our students; whether it is advising our younger friends to make the most of their strengths; whether it is developing and helping build our departments, colleges, universities, their links to business, government and community, and disciplinary organizations like our own association; whether it is interaction with our colleagues in mutually stimulating intellectual activity, and perhaps even, thinking, writing, and sharing of our ideas with others. When on occasion we find what we write to satisfy ourselves also happens to be of sufficient interest to others, we might even publish such writing. Imagine, being appreciated for each and all of the above activities, and their various combinations, according to our individual taste and inclinations, without being forced into the strait jacket of a standard promotion formula based on publications alone. Imagine such a world where each of us could do our best to achieve what we have the greatest talent for, and being appreciated for the excellence in whatever academic activity we choose to engage in.

3. Teaching

Some people think that the street image of accounting and accountants could use some improvement. Imagine why this is the case, and what can we do about it? Most people's life-time exposure to accounting consists of that one introductory college course. Why do so many of our students find debits and credits, balance sheets and cash flow statements so puzzling, if not difficult, even though to the teachers they are simple, and clear as daylight. Perhaps teaching accounting, too, calls for changing the intuition of the students.

Most courses in college start out by asking the big questions of the field, and helping the students learn the general answers to them. Economics 101 start by asking who produces what and who consumes what in society, and how is it determined. Physics 101 starts by asking big questions about why apples fall to the earth, how we hear, see, light up this room or store information on a magnetic strip on the back of a credit card. The same is true of biology, political science and psychology. Put a question about our world or society to our students, questions whose meaning and importance they understand, and then help them discover and understand the answers. Once they understand the question, and its meaning and significance, they never forget the answer.

Most accounting courses are radically different. We do not start by asking a question whose significance is immediately obvious to our students. Instead we

start by asking them to read and memorize *an* answer to the questions that are rarely revealed to them.

For example, debits and credits and financial statements are ingenious answers developed to an important and difficult question of human society: How do we get human beings, with their inherent tendency to be generous as well as selfish, to cooperate in generating wealth and prosperity. Debits and credits, balance sheets and income statements, budgets and costing, are a solution we have developed over the centuries to address this problem, and live better.

But we rarely start our courses with asking our students this basic question. Imagine that a way to get them interested, and to make what we teach interesting, might be to make them see the question, and whet their appetite for the answer. Then we can help them learn how to find their own answers to the problem in specific situations they face, and teach them examples of answers others have found. Thus debits and credits, rules of accrual and costing, become the answers, leaving room for the creativity of students to find answers of their own for situations in their experience.

Imagine the impact of standards on education and training of accountants. How do they affect textbooks, curricula, examinations, and the classroom discourse? Have they shifted the focus of accounting education from preparing professionals to think about the best way to deal with any given event or transaction, to what the rule book says. Can we attract talented youth to study or teach a discipline that consists largely of memorizing a fixed set of rules? The power to think is discounted once alternatives to the official creed enshrined in the written standards have been declared out of bounds by authority.

Imagine the effect of standards on the attitudes of corporate managers and auditors. Standardization is the opposite of making critical judgments after considering the relevant facts. Do standards provide us a cover from having to take personal responsibility for our judgments? Why is it that after the thirty years of intensive pursuit of the “gold standard” of accounting, the recent scandals exposed them to be simply fool’s gold? Why has the chase of the dream of uniform accounting repeatedly revealed it to be a mirage?

4. Our Organization

Finally, consider the organization of academia. Imagine a world in which we actually read, not just count, the work of our colleagues to make up our individual minds about how interesting and exciting we find their content. Imagine a world in which there are no A-journals, or B-journals, or C-journals, only articles which are interesting, innovative, and important.

Imagine a world in which, instead of dividing the faculty groups and PhD programs into increasingly narrow sub-areas of accounting, we form larger

aggregates in which we exercise freedom to address problems of any aspects of management that catches our fancy. If the vast disciplines like physics and psychology can have a single PhD program that train their candidates broadly before they choose a specific thesis topic, would it really be so difficult to educate our students in management, instead of in accounting, finance or marketing? Today, making an argument for anything broader than, say, behavioral auditing or empirical capital markets is a tough sell in many of our departments.³

Imagine the recognition that no matter how we organize our journals, they would always reflect the strengths and weaknesses of our community as a group. Our journals are simply be reflections of our own selves. When we find the journals lacking, of course we should try to fix the problems. But the journals of any discipline cannot carry the entire burden of correcting our own shortcomings as a scholarly community.

Imagine, if “The fault, dear Brutus, is not in our stars, but in ourselves.”

Conclusion

I have shared with you my own meager imaginings. I wonder what other uncounted imaginings lie unexpressed in the conscious and unconscious selves of us all. I wonder which, if any, of these imaginings are worth being transformed into reality? Which, if any, of these imaginings would someone try and transform into reality? Which of these attempts at realization will succeed? I do not know the answers to all these questions. But I do know that there is no chance that the world will change if we do not imagine what is not. It will not change if we do not ask, after Bernard Shaw: Why Not? And it will not change if we do not welcome the risk of translating our own unorthodox, rebellious thoughts into reality.

The battle to have the imagined and the hypothetical taken seriously is not an easy one. In our own field, in spite of over a century of debate, opportunity cost remains but a poor cousin to sunk costs, even in decision making contexts.

For accounting to advance as a discipline, and for accountants to continue their glorious tradition of contributions to society, we must allow ourselves to imagine the future alternative worlds of accounting. Let us celebrate and explore the power of accounting in concrete and imagined forms, share our dreams, work to change the world in ways that our unique gift of the power to imagine allows us humans to do, and thus earn our keep from society.

³ See Biondi and Zambon (2012) on creation of *Betriebswirtschaftslehre* in Germany, and *Economia Aziendale* in Italy at the beginning of the twentieth century.

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