Devising Efficient Accounting Standards

Shyam Sunder, James L Frank Professor of Accounting, Economics, and Finance, Yale School of Management, talks to Tarun Jain, Assistant Professor of Economics and Public Policy at the Indian School of Business (ISB), about accounting standards, experimental economics and education.

Tarun Jain: In your research you have emphasised that companies should be allowed limited choice of which financial reporting standards to use, be it the International Financial Reporting Standards (IFRS) or the US Generally Accepted Accounting Principles (GAAP), because neither business environment nor social norms are uniform. What does this mean for India which has a very diverse set of social and business norms that are rapidly changing?

Shyam Sunder: A single set of standards and the authority to write that set being given to a single regulatory body runs the risk of getting stuck with a bad standard. Such a system affords little opportunity for improvement through trial and error, comparison and experience. Before we enforce a single set of standards everywhere, we should be sure that it is the best standard. It is like making a single model of car or computer the worldwide standard with no variation permitted. The consequence can be no further evolution - no improvement in cars, computers, or accounting in our case.

From past experience we know that our ability to devise efficient standards in the first place is limited at best. In fact, there are diverse perspectives on what attributes a good or efficient standard should and should not have. Additionally, we are living in an environment where written accounting standards induce businessmen to change their transactions and instruments to minimise taxes or to improve the appearance of their financial reports to suit their own goals. Our choice is not between the extremes of total standardisation at one end and no standards whatsoever (leaving everything to the market) at the other. We have to find a balance. For a developing economy like India, that balance could be shifted slightly to favour greater standardisation. We cannot rely entirely on a single set of standards, or for that matter, entirely on any written standards. We need a balance between written standards and forces of market competition on one hand, and a balance between standardisation and social norms on the other. The moral code of society, business community and accountants also plays an important role in determining what kind of financial reporting is and is not acceptable. Social norms are important to the extent that businessmen and accountants feel constrained by the social sanctions of their community that they belong to. But financial reporting cannot be left entirely to regulators and legal enforcement. Years of experience teaches us that law and formal regulation are not capable of ensuring acceptable behaviour in the absence of social norms.

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