Accounting and the Firm: A Contract Theory

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Abstract. We can think of each organization as a set of contracts among employees, customers, managers, shareholders, suppliers, auditors, etc. Each party seeks its goals through exchange of resources with the organization. Accounting helps implement and enforce this contract set by tracking resource inflows and outflows, furnishing information about fulfillment of contracts by various parties, distributing information to attract new participants in the organization, and by making some information public to reduce the risk of conflict and deadlock at the time of contract renegotiation. Accounting itself is a matter of negotiation and bargaining among the participating agents and the choice of the accounting system forms a part of the contracts it helps to implement. This way of looking at accounting encompasses virtually all its aspects including bookkeeping, cost and factory accounts, tax accounting, auditing, managerial accounting and financial reporting. In this sense, the contract model of accounting offers a unified economic approach to accounting, as well as a way of linking organizational forms to accounting solutions best suited to serve each.