

CRITIQUE TO THE LOGIC AND THE NORMATIVE SENSES OF POSITIVE ACCOUNTING THEORY

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Abstract

This essay argues that Positive Accounting Theory (PAT) is not better than other forms of theorizing though the supporters of PAT claim that PAT avoids normative statements. PAT as claimed by Watts and Zimmerman is free of value, just explains and predicts accounting practice. They also claim that PAT answers what is and why, not what should be nor how to do. In contrast normative accounting theory tries to answer what should be done by accounting practices to contribute the social change (i.e. social welfare distribution). As a matter of fact what is claimed by PAT supporters is not true because accounting, as an applied discipline is impossible to be free of value. Accounting discipline must have such purpose orientation. Accounting theory will be meaningless if it just explains and predicts accounting practice without providing prescriptions. Therefore it is clear that PAT is not better than other forms because it still leaves too many questions unanswered and makes accounting to be meaningless.

INTRODUCTION

The problems of accounting theory construction have lead to the debate of deductive approach against inductive approach and the two streams of positive accounting theory against normative accounting theory. On the one hand, positive accounting theory resulted in research that based on empirical observation, and then based on the inductive approach the theory is constructed. The positive accounting supporters claim that they are free of value, explain and predict accounting practices. On the other hand, normative accounting theory is constructed based on normative approach. The normative supporters argue that accounting theory should drive the practice according to the objective of the theory (i.e., accounting standards and procedures), so that the objective of the theory will be achieved. Therefore accounting theory should provide prescriptions to accounting practices because it must have such purpose of orientation.

However, it is claimed by the positive accounting supporters that positive accounting theory is better than other forms of theorizing because it avoids normative statements. As a matter of fact this is not true because positive accounting theory is not free from normative approach (i.e., in building the hypothesis). It can be explained in the area of critique to the logic of positive accounting research, and the normative senses of positive accounting theory. The essay begins with the nature of positive and normative accounting theory then the discussion is emphasized on critique to the logic of positive accounting research and the normative senses of positive accounting theory.

THE NATURE OF POSITIVE ACCOUNTING THEORY VS. NORMATIVE ACCOUNTING THEORY POSITIVE ACCOUNTING THEORY

The basic idea of positive accounting theory (PAT) is adopted from the Pop-

per idea about *what is theory* in science (Boland & Gordon, 1982, p. 145). The function of theory is to explain and predict about a field or phenomena that is being observed. Therefore a theory is descriptive and explanative but not normative. The theory is not to conduct nor drive the phenomena to be in such a way. A theory is long life true since there is not a new theory that proves or refutes that the old theory is fail, so that, a theory cannot be proved as a truth but it is possible to be proved as a false (refutable). Furthermore, the function of a theory is to answer *what is* and *why* not *what should be* nor *how to do*.

Positive accounting theory was revealed to the debate by Watts and Zimmerman book "Positive Accounting Theory". Referring to the Popper idea, it is claimed that the objective of accounting theory is to *explain* and *predict* accounting practice (Watts and Zimmerman, 1986, p. 2). Furthermore, it is argued that their definition of accounting practice is broad based on the reason that the development and nature of accounting is closely tied to auditing, auditing practice is included as part of accounting practice (Watts and Zimmerman, 1986, p. 2). They define *explanation* as providing reasons for observed practice (i.e. why a firm use the LIFO method of inventory rather than FIFO method), and *prediction* is defined that the theory predicts unobserved accounting phenomena that is not always necessarily future phenomena, but it can be phenomena that have occurred but on which systematic evidence has not been collected (Watts and Zimmerman, 1986, p. 2).

In addition, the objective of PAT is to provide explanation and prediction that is useful for interesting parties in accounting information to maximize their wealth (i.e. accounting practice rooted in the purpose of managers) (Williams, 1989, p. 455). Therefore, to achieve this objective, accounting research must be conducted empirically to

develop PAT. Furthermore, because PAT is to be explanatory in the sense envisioned by positive theorists, it must contain at least one premise or proposition that permits causal attribution. Finally, PAT is based on assumption that individuals have interest in accounting information act to maximize their own utility (Williams, 1989, p. 458).

NORMATIVE ACCOUNTING THEORY

Since accounting failed in explaining about the great depression in 1930's, it was started that there should be a theory that influences the accounting practice so that the practice is running in to achieve a certain objective. Then, the research to develop accounting theory became normative and tried to answer the question what should be done by accounting practices to overcome the collapse of business.

Dominant normative theories developed in the 1950s and 1960s (Deegan, 2003, p. 92). The main objective of normative accounting theories is to provide guidance to individuals to enable them to select the most appropriate accounting policies for given circumstances (Deegan, 2003, p. 90). Therefore, the result of normative accounting research should provide prescription to inform others about the optimal accounting approach to adopt and why this particular approach is considered optimal.

Normative accounting research has resulted accounting theories that are relevant for the setting of financial reporting standards (Mozes, 1992, p. 93). In this case, the FASB's (U.S Financial Accounting Standard Board) call for normative research can be interpreted as a request for accounting researchers to investigate whether the user-specific and decision-specific qualities that standard-setters require are present in the accounting data (Mozes, 1992, p. 93). A successful example of normative accounting theories is conceptual framework for financial reporting published by FASB. It was

started in 1978 by SFAC (Statement of Financial Accounting Concept) No. 1: Objectives of Financial Reporting by Business Enterprises. Conceptual framework is defined by FASB as follow (FASB, 1980, p. i):

Conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and reporting. It is expected to serve the public interest by providing structure and direction to financial accounting and reporting to facilitate the provision of evenhanded financial and related information that is useful in assisting capital and other markets to function efficiently in allocating scarce resources in the economy.

The word *prescribes* used in the definition shows that the conceptual framework is a normative theory of accounting. According to the FASB's definition, the main goal of conceptual framework is to lead the consistency of accounting standards determination, which means, there is no contradiction among the accounting standards. It is expected that accounting standards be derived from the same concepts, so that, the standards form a coherent set of functional rule. In detail the roles of conceptual frameworks are:

1. Guidance for accounting standard setting body to determine accounting standards,
2. To reduce or omit inconsistency in standard setting,
3. To be a guidance and framework in evaluating the existing accounting practices,
4. To release the controversies of accounting standard setting.

Normative accounting theory supporters argue that accounting standards

should be derived from norms or certain concepts, so that, the accounting standards will be consistent, systematic, logic, and form a coherent set of rule. The norms or concepts are conceptual framework that is used as guidance and basic norm in standard setting process.

CRITIQUE TO THE LOGIC OF POSITIVE ACCOUNTING RESEARCH

The main objective of PAT is to explain and predict accounting practice by making a number of assumptions about human behaviour. It has been assumed that individual actions are based on the attempt to maximize their welfare (Deegan, 1997, p. 64). In this case PAT does not provide prescription for accounting how to maximize the welfare, but describe *what is* rather than *what should be*. Watts and Zimmerman state that PAT is concerned with explaining accounting practice. It is designed to explain and predict which firms will and which firms will not use a particular method of valuing assets, but it says nothing as to which method a firm should use (Watts & Zimmerman, 1986, p. 7).

It seems that PAT does not have roles to influence society because it has been restricted to explain and predict. The free value claimed by PAT supporters has restricted that positive accounting research and its result just to explain and predict, but not to advise which method should be adopted by managers to maximize their wealth. Logically, under an extra ordinary condition like high inflation, managers need to have the best method to maximize their wealth (i.e. to value assets). Therefore PAT still leaves unanswered questions and confusions to the managers. Simply providing description, explanation, and prediction of accounting phenomena provides little social benefit and does not advance the accounting discipline.

The level of universality of PAT is also questionable. Theory should be universal because it is developed under objectivity (free of value). The theory in PAT is developed under positive research that assumes that individual acts to maximize their welfare. Hypothesis is tested under general assumption that is bias and subjectively designed. The following are common question responses to assumptions made by PAT researchers (Neu, 1997, p. 56): Do managers actually behave in this self-interested a manner? Why does the board of directors let them get away with it? There must be other influences on behaviour? Obviously deviants will arise in reality and empiric condition as explained by standard deviation number. Therefore, PAT fails to explain and predict a practice that does not fulfil the assumption. In this case PAT seems not to be theory because sometimes it is not universal. Comparing with the gravity theory PAT is far from universality. The gravity theory is universal because it is applicable wherever it is applied. It pure explains about the phenomena of gravitation and predicts that everything will fall down to the earth, so that there is no deviation found in this theory.

THE NORMATIVE SENSES OF POSITIVE ACCOUNTING THEORY

It cannot be denied that accounting is not pure science as physic, biology, math, chemist, etc. In contrast accounting is an applied science, so that why accountants use their creative skill and ability in solving given problems. The claims by Watts and Zimmerman that PAT is to explain and predict accounting practice is very different from Popper's qualification of theory that is appropriately applied for pure science not applied science.

In much more cases applied scientists use the research of pure science to develop value but it does not make the applied science becomes pure science and be free of

value. Even though pure science's research used by applied science it does not mean that it just explains and predicts, but still plays an important role to solve problems facing, like to answer what should be done. Matessich (1995, p. 260) gives a good example; in medicine discipline physicians are beseeched, these days, by patients who clamour for alternative choices instead of the one-sided and exclusive treatment with high-powered but potentially dangerous drugs. It is only a good physician will inform his patient about alternative treatments (including *natural* remedies). In this case, a good physician as an applied scientist uses pure research but he does not just explain and predict a phenomenon to his patient, but also gives advice and alternatives. It can be taken a parallelism with accounting, indicating for each pros and cons, so a good accounting academic or practitioner is the one who offers his client a spectrum of alternatives together with the pertinent information to help the client in making an intelligent choice depending on the latter's needs and values (Mattessich, 1995, p. 260).

PAT is free of value as claimed by Watts and Zimmerman. As matter of fact it is not true because PAT is in the area of accounting as applied science. Accounting theories are developed into accounting concepts, standards, and procedure. It will be very meaningless if accounting theory does not have such purpose-orientation. Emphasizing ethical (instead of pragmatic) norms-particularly those in accord with social goals might lead to a predominantly interpretative and critical methodology, which argues that no accounting theory is value free (Mattessich, 1995, p. 262). Tinker, Merino, and Neimark (1982, p. 167) contrast the Positivism with an alternative philosophy of Historical Materialism. It is shown that Positivism is an inadequate epistemological foundation for accounting, requiring too many acts-of-faith and leaving too many questions

unanswered. Furthermore, Tinker et al (1982, p. 167) note that PAT is shown to be an illusion because research in accounting (or any science) cannot be value-free or socially neutral. Therefore accounting should play an important role in achieving social welfare and it cannot be achieved by just providing explanation and prediction, unless accounting is meaningless. It is clear that if PAT is still in the area of accounting it will not free of value, but also value-laden.

Accounting should play an important role in maximizing social welfare; in a macro area it is national macro economic objectives. It was argued by Hawkins (cited in Solomons, 1978, p. 67) that:

“The (FASBs) objectives must be responsive to many more considerations than accounting theory or our notions of economically useful data.... Corporate reporting standards should result in data that are useful for economic decisions provided that are the standard is consistent with the national macro economic objectives and the economic programs designed to reach these goals.”

Accounting is a tool to achieve social goal, that is, national macro economic goals in a country where accounting is applied. Therefore, accounting structure in a certain country is very possible different from other country. It must be designed in such a way that is appropriate with the country. Accounting standards should be developed to influence the wealth distribution of a society. According to Horngren (1973, p. 61), reaching this goal makes accounting standard setting is a political process:

“The setting of accounting standard is as much a product political action as of flawless logic or empirical findings. Why? Because the setting of standard is a social decision. Standard place re-

strictions on behaviour, therefore, they must be accepted by the affected parties. Acceptance may be forced or voluntary or some of both. In a democratic society, getting acceptance is an exceedingly complicated process that requires skillful marketing in a political arena.”

Furthermore, May and Sundhem (1976, p. 750) state that:

“In practice as well as in theory, the social welfare impact of accounting reports apparently recognized. Therefore it is no surprises that the (Financial Accounting Standard Board) is a political body and, consequently, that the process of selecting an acceptable accounting alternative is a political process. If social welfare impact of accounting policy were ignored, the basis of existency of regulatory body would disappear. Therefore, the FASB must consider explicitly political (i.e., social welfare) aspects as well as accounting theory and research in its decisions.”

It has been argued that accounting plays an important role in achieving the distribution of social welfare, instead of just explaining or predicting accounting practices. Sometimes the process could be a political process and it cannot be denied that it is not free of value. Finally, it can be argued that if accounting is free of value, just explaining and predicting accounting practices, accounting will be meaningless and do nothing in achieving social welfare.

CONCLUSION

To conclude, it is clear that “explanation, prediction, neutrality, and free of value” as claimed in positive accounting theory have restricted accounting theory and its practice in supporting the distribution of

social welfare. Accounting practice must achieve its objective that is not to represent economic reality in a purely scientific way, but to approximate it pragmatically on the basis of particular norms. Unfortunately, PAT supporters seem to be unwilling to see the evidence supporting the view that academic accounting is an applied science discipline. Accounting must play an important

role in achieving the maximization of individuals and social welfare. Therefore it is impossible for accounting to be free of value. Accounting researchers should develop theory of accounting that is interested in social welfare distribution so that accounting is not neutral, but it should have prescriptions to the contribution of social development.

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