Sorting and comparing: Standard-setting and “ethical” categories

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**Abstract**

The Financial Accounting Standards Board (FASB) describes its public interest function as “…developing standards that result in accounting for similar transactions and circumstances in a like manner and different transactions and circumstances in a different manner (Facts about FASB).” This statement implies that rule-makers possess an expertise that makes analogizing transactions or circumstances to other transactions or circumstances unproblematic. In this paper we utilize two instances of standard-setting, SFAS 123R and SFAS 143, to demonstrate from FASB’s analogic reasoning in these cases that similarity and dissimilarity are not so easily ascertained. A judgment about similarity invariably involves ignoring some perspectives of similarity that would lead to substantially different conclusions about the appropriate accounting. We also illustrate via the two examples the inherent value judgments that underlie the conclusions reached by FASB and how these value judgments raise questions about the ethics of the current standard-setting process.

1. Introduction

Formal financial accounting and reporting practices in the U.S. change continuously. Sometimes, these changes are connected to the emergence of new transactions or events. Other times, they are linked to dissatisfaction arising from perceived flaws within existing accounting standards. Although many groups may participate in the process of altering promulgated generally accepted accounting principles (GAAP), the designated standard-setter maintains jurisdiction over the process — adding new projects to its agenda, shaping and defining these projects, expanding and contracting their scope with the issuance of exposure documents and final standards. The standard-setter’s authority is based upon its expertise that is purported to be of a value-free, technical nature. Acknowledging this alleged expertise through its executive agencies, e.g., the SEC, society defers to the “experts” to write accounting rules. Thus, the accounting standard-setter becomes part of the governmental regulatory apparatus. As discussed in the following section, the designated accounting standard-setter follows defined procedures in issuing accounting rules: processes to decide the content of its agenda, to allow opportunity for comment on proposals and to evaluate the relevance or irrelevance of these comments. Using two instances of standard-setting — employee stock options and asset retirement obligations, we turn our focus away from the details of these processes and towards the construction of similarity and difference that forms the foundation for accounting standard-setting efforts. In so doing, we highlight the inherent value judgments required to accomplish this construction and the complex intertwining of ethical and technical concerns in establishing the content of accounting rules. We examine the choices made during the standard-setting process and how such choices contribute to the construction and perpetuation of a particular moral and social order.

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1.1. Standard-setting: process and expertise

In the U.S., the Financial Accounting Standards Board (FASB) is currently designated as the writer of accounting rules and guidance. As a public regulatory agency, the FASB has opted for the "... the classical New Deal model of an independent expert..." rather than "... the post-war pluralistic model of a politically responsive regulator" (Bratton, 2007, p. 9, emphasis added). In adopting the independent expert model the FASB has established a well-developed and documented due process procedure that draws upon the Administrative Practices Act. This act must be followed by over 50 U.S. regulatory agencies (e.g., Environmental Protection Agency, Food and Drug Administration) when creating the rules and regulations necessary to enforce major legislative acts like the Clean Water Act or the Occupational Safety and Health Act. The deployment of the Act’s procedures by FASB is an explicit acknowledgment that FASB is, de facto if not de jure, a U.S. federal government regulatory body writing some of the rules and regulations for enforcing the Securities Acts. However, the FASB due process procedure is incompletely analogous to the Administrative Procedure Act in certain very significant ways. For example, there is no explicit process through which a party putatively injured by an accounting standard can seek redress nor is there any process whereby an interested person has a right to petition for the repeal of a rule.2 Further, adopting the due process procedures employed by other federal regulatory agencies may prove insufficient given the differences between accounting rules and those rules issued by other regulatory agencies such as the FDA. The rules and regulations promulgated by these agencies such as the EPA, FDA, FCC or FAA may be based, in theory at least, on science. For example, the FDA’s approval of new drugs is based on an extensive assessment of the benefits and risks of new drugs through scientifically rigorous double-blind, placebo experiments. There is some reasonably sound scientific basis for FDA actions. In contrast, accounting rules can have no grounding in any kind of science that provides even a minimal degree of causal reliability (Ravenscroft and Williams, 2009). As Sunder (2005, p. 6) notes: “Rule makers have little idea, ex ante, of the important consequences...of the alternatives they consider.”

Historically, accounting and financial reporting practices have been based on social norms or subjective expectations: “The object of norms is behavior (emphasis added), not belief” (Sunder, 2005, p. 9). Further, “...there can be no authoritative source (emphasis added) of accounting norms either, even as individuals and groups remain free to provide their own statements of what the norms are (Sunder, 2005).” Consequently, FASB rules rest primarily on a conceptual framework consisting of the ontological assumptions and value judgments of the FASB itself. FASB is in substance a writer of law which has also created its own constitutional guidance.3

Rather than focusing on the processes followed by the accounting standard-setter, we focus on the content of its work. This standard-setting work is most frequently described as resolving the measurement and recognition problems posed by particular transactions and events. Such measurement issues are often posed by FASB as technical problems – should we employ current market prices or historical costs? Should we estimate future cash flows and, if so, what interest rate should we employ to calculate the present value of such cash flows? However, this focus on measurement issues ignores an equally, if not more important, element of the work performed by the standard-setter – the work of sorting transactions, events and objects into the pre-existing financial statement categories – assets, liabilities, equities, revenues, expenses, gains and losses, thus eliding the essentially ethical nature of FASB dicta.4 Categorization and classification, the sorting and ordering of things and events, are at the heart of accounting standard-setting. Further, accounting categories are regarded as mutually exclusive in that a thing cannot be simultaneously categorized as an asset and a liability, as an asset and an expense, as an expense and equity. Instead, the objects incorporated within financial statements must be placed into one and only one category (although under certain conditions they may be subsequently re-classified). Equally importantly, many objects are placed outside accounting categories and thereby excluded from the scope of financial statements.

How are events, transactions and objects placed into or excluded from accounting categories? During the standard-setting process and within issued accounting guidance, reference is frequently made to the FASB’s conceptual framework and how particular events, transactions or objects “fit” into the categories employed within financial reporting, the elements of financial statements (see SFAC no. 6). However, these elements and their definitions can only provide a starting point for any exercise in accounting classification.

Categories such as financial statement elements should be regarded as radial categories. Lakoff (2002, p. 6) describes these categories as “not definable in terms of some list of properties shared by every member of the category. Instead, they are characterized by variation on a central model.” Johnson (1993) makes a similar observation in arguing that although

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2 Another important difference is noted by Sunder (2005, p. 3): “Unique among agencies that make rules, rule making is the only function (emphasis added) of the FASB. A permanent rule making bureaucracy with no other function must make rules to justify its budget and existence.”

3 The FASB process is more akin to that of developing Talmudic Law than one of developing empirically justified efficient courses of action. Moore (2009) provides an analysis of the failure of conceptual frameworks and in substance argues accounting rules are promulgated to represent what is little more than a myth.

4 Busch (2000) discusses the essentially ethical nature of “standards.” Citing the work of Boltanski and Thévenot (1991) that was based on “How to” manuals, Busch notes “…that while each of these worlds has a coherent set of standards for achieving justice, conflicting notions of justice across worlds must be the subject of discussion, debate, and eventually compromise (Busch, 2000, p. 276).”

5 Lakoff (2002, p. 8) uses the category “mother” as an example. The central model contains four sub-models: birth model, genetic model, nurturance model, and marriage model. Most of us understand our mother to be she who gave birth to us, provided us with half of our genetic code, nurtured us to adulthood, and is married to our father. However, there are senses in which we properly use “mother” when all of the basic conditions are not met, e.g.,
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