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Better financial reporting: Meanings and means ☆

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A B S T R A C T

What is the meaning of better corporate financial reporting? How can financial reporting be improved? There are many claims of shortcomings of financial reporting. Conflicts among these claims point to the political elements of the problem inherent in collective choice in a society. Since "better" depends on the interest group whose perspective is chosen for analysis, politics lies at the heart of accounting policy. The set of possible means of arriving to any agreed upon meaning of "better" includes not only regulation, but also social norms and market competition. Judiciously combining all three approaches, instead of relying on any one alone, may help us improve financial reporting. This paper examines the meaning and means of better financial reporting.

1. Introduction

How should we think about and improve financial reporting? The topic has received much attention during the past century. Perhaps an initial step toward making progress is to recognize that the problem of designing such regimes and standards is not unique to accounting. There are more than five hundred domestic standard-setting organizations in the United States alone and hundreds more in other countries. These organizations are busy defining their technical and business environments and setting standards for everything from ships to shoe laces. In addition, there are international bodies who set standards for things such as radio transmissions across national boundaries. An examination of the accounting regime in the larger context of other products and services in society may

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help us appreciate the costs, benefits, limitations, and economics of developing a better financial reporting regime (Jamal and Sunder, 2011).

What would make financial reporting better? Not surprisingly, there is no unique answer to this question. We examine possible answers based on attributes and goals, as well as financial reporting simply as a social practice. The variety of answers encompasses economic (consequential), political (collective choice in the presence of diversity of interests) and sociological aspects of financial reporting (see KPMG Australia, 2010 as an example).

How we might move in the direction of a specified meaning of "better" in financial reporting is the second major issue we address. Design and emergence are two important ways of thinking about this problem. When we have sufficient understanding of the structure of a problem, e.g., a quadratic equation, it can be solved by applying the knowledge of the relevant domain. When our understanding of the structure of the problem and knowledge about the relevant parameters is incomplete, the design approach yields imperfect answers. In stable environments, successive attempts to solve the problem in light of past experience may help improve the solutions if small changes in the solution cause only small changes in its performance. In unstable or changing environments, and discontinuous domains, even successive attempts at redesign are not guaranteed to improve the results. Solutions, or practices, may simply emerge from a random process of social evolution and become accepted as received practice by the force of convention. We examine the likely consequences of various institutional mechanisms—regulation, norms, and competition—that societies use in the hope of either improving their practices, or simply rationalizing whatever practices may have arisen through history.

Section 2 examines the various meanings of better financial reporting and Section 3 explores the alternative means of approaching the chosen goals. Section 4 suggests some missing elements and Section 5 synthesizes the discussion on a blended approach to improving financial reports.

2. What is better financial reporting?

This question yields diverse answers. Issuing calls for "high-quality standards" as some boards with authority are prone to do, assumes that quality can be assessed in an agreed upon manner and that issuance of standards is an important, if not the only, route to better financial reporting. Instead, we begin with a six-way classification of the perspectives used to identify "better" in financial reporting: three based on attributes of financial reporting, two on financial reporting as instruments for serving specified goals, and one procedural. The attribute-based approaches include three variations: (1) pursuit of truth, (2) assessment based on qualitative attributes of the reports considered desirable, harmful, or deserving a balance, and (3) some measurable statistical or descriptive properties of the data, disclosures, and explanations in the reports. The two functional approaches are the efficacy of financial reporting in (1) serving some broad societal goals and (2) the goals of one or more specific classes of participants. A final approach sees accounting simply as an emergent social practice, ritual, or tradition, not rationalizable as a relatively effective means of achieving any specific attributes or goals other than social harmony through acceptance.

Given the nature of collective choice and social policy, it is rare for any such attempt to succeed in clearly identifying what should be regarded as better financial reporting. Trade-offs must be made in the presence of non-commensurate and conflicting attributes, as well as within- and across-person objectives. The absence of even reasonable, much less accurate, data on preferences, costs and benefits leads to ambiguous conclusions. Indeed, caution is necessary because it is a challenge to be both knowledgeable and confident about the merits of alternative formulations; it is tempting to become infatuated with one's own perspective.

2.1. Attribute-based approaches

The most frequently used approach to improve financial reporting is to focus on its attributes. Over years of accounting discourse, truth and fairness are often mentioned. Faithful representation, timeliness, relevance, reliability, verifiability, uniformity, consistency, comparability, cost-benefit efficiency, conservatism, and robustness to manipulation and fraud are also among the proposed attributes of a