

**Research article**

## **Regards and Views to Accounting Standards-setting**

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### **Abstract**

Considering that the lacks which exist in market system, we should understand necessity of existing of standard which in this among can accept the responsibility of standard-settings as a suitable choice. In set and execution of standard, we must consider a scientific viewpoint and a syllogistic approach. On the other hand, the set of accounting standards include important economic results and with their set, some group profit and some other group loss. As result process of standard-setting is affected political aspects and beneficiary individuals attempt to apply their view like government, investors and managers effectively and get many profits for themselves. Careless to desire to beneficiary groups can be an obstacle for execution standards. So, the best strategy for standard-setting, Regulatory Approach and give independence to job and or an important role in it. In discussion for execution of standard, there is two complete methods which one of them is Principles-Based and another one is base on rules, determine region of view rather than a set of standards. These two methods play a key role in explanation of professional mediation rate in exception of standards and their public or private. **Copyright © IJEFF, all rights reserved.**

**Keywords:** Market Method and Regulatory Approach, political- additional viewpoint, theoretical - Scientific Viewpoint, strategies for standard-setting, method Principles-Based and regulations.

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## Introduction

In discussion related to standard position method, is determined examining of free Market Approach and Regulatory Approach hat Free Market is not suitable approach because of asymmetric information and free riding and other reasons and the fall of market is witness this matter, in 1929. In contrast, Regulatory Approach is more suitable choice for enactment of laws and regulations and establishment of SEC had been like is in 1934. So, in standard-setting by public or private sector, there are 3 kinds of Accounting Standard position regimes which two types of it is private and one type of it is public. First groups include the countries which its accounting job is responsible for standard-settings (for example, Canada, Hong Kong, Newland, and Taiwan).

Second group includes countries that independent group in its Spread Accounting Standards by a job (for example, America, England). In fact, the second group is derived from first group which American experience shows this subject. Third group include the countries that the government is responsible for enactment of accounting standards in it's (for example, Australia, China, France, and Malaysia). Some of these countries like Australia are derived from first group. From the point of law and regulation regulatory strategies, adjusted strategies are true of first two groups. In the third group laws and regulations spread by governmental laws monotonously. In fact the first two groups have been more successful in set of accounting standards and affected the third group countries. In relation to standard-setting method there are two viewpoints, political-additional and theoretical -scientific viewpoints which examines in this article. So, there are two viewpoints about standard-setting Principles-Based and standard-settings based on regulations about enactment of laws and regulations that discusses in details. Finally, the consideration is presented about planned discussions in this article.



## 1. Standard-setting methods

In financial markets, legislation is necessary for producing information because of asymmetric information and all people information of activities of management and private and inside information of firm, there is no reason for supporting of persons. In addition to this vital problem, there are other problems that result in request for producing information and then request for set of laws for producing of information.

For discussion about responsibility of process of standard-setting, there are two vital questions:

First question is that the responsibility of set of accounting standards to free market or Standard-settings authorities?

And second is that accounting standards should be collected in private or governmental sector?

In relation to the first question, there are different viewpoint that are discussed later.

### 1-1) Free Market Approach

Accounting can be considered as an informational industry means accounting job is production of information. Supporters of free Market Approach discuss that like ach production, in this trade must move supply and demand elements. There is a need for accounting information by costumers and a demand of its information by the firm in the financial inventories form. So, there is an average price for accounting information among. Otherwise, this average price is reduced anywhere and is deleted that



provider knows information suitably but customer should be believed that this cost is equal to or less than profits arising of information and consequently that information are not presented. In other word, Free Market pressures are applicable for determining of kind of accounting information and necessary standards for emphasizing their.

### 1-1-1) Agency Theory

Previous method is supported by some agency supporters. This theory tries to explain about agency relationship among persons who work in institution specially in relation to accounting information. Because main important element is accounting information, it is said that Agency Theory tries to explain about theoretical explanation of accounting job.

Agency Theory is one the most important components of accounting positive theory. Evident theory is based on individual profit that looks at an agency like a set of contracts. Because the people who activate in an agency ask for individual profit, these contracts should be existed. Of course these contracts have cost like the cost that spend for conversation to beneficiary persons or keeping of this approach. (Figure 1)



Figure 1: Positive Theory and Agency Theory<sup>6</sup>

Requesting for financial information can be classified in form of super vision purposes and decision-making and Agency Theory takes care of requesting form position. Provisional relations are where manager transfers part of decision-making to his agent. Based on positive accounting theory he two parties of contract act based on their individual profits. Obvious example of Agency Theory is relationship among shareholders and managers of the firm. Manager (of shareholders), preys care costs to sure that agent (of managers) act based on their profits. The best example of care costs is financial inventories of auditing cost. On the other hand, for the agent present particular about regard of manager profits, necessary costs are accepted by agent. The best example for necessary costs, is financial inventories providing costs, because it cannot be supplied two parties profits in spite of it, it must be paid another costs that is called remained costs.

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<sup>6</sup> Note: This Shape is plotted by Dr. Kambiz Forqandust Haqiqi to teach in accounting theory course.

One example of these contracts can be replaced for public report. If accounting be regulated with help these contracts again, then market mechanism can get enough information and get a balanced point which equals in the cost and profit of providing information.

Supporters of this viewpoint believe that obligatory revealing is unnecessary and unsuitable because we can rely on market force for providing each kind of information.

### **1-2) Regulatory Approach**

Criticizers of Free Market Approach knows unreal this approach. In addition to this theory does not apply because Market mechanism can't get balanced and suitable society price for accounting information. For this reason accounting information is a public good and when the information gets out of the firm, it is available for everyone. Because an inventory is not sent for all accounting information users, providers motive less for its production and only mediation of regulatory organization s can force instructions providing necessary information o supply actual request of guaranteeing efficient invest market. To this problem is said Free riding.

On the other hand, presentation of information is special to agency and agency desires to sell less information to the highest price. So, in viewpoint of society, obligatory report provides a lot of information with less cost.

Even if there is efficient market accounting information, a regulatory organization is necessary, because users can't be agreed about their needs and accountants do not agree about usable methods for getting information where by a collected authority in necessary for decision-making.

### **1-3) Private or Public sector**

The second question which we asked was that does Standard-setting should make in public sector or in private sector?

In history time, there has been two methods for enactment laws and regulations, one European viewpoint and another American viewpoint, which every one based on different philosophy in relation to need to laws and regulations. In U.S.A the enactment law and regulations has made by Boards and independent commissions at least since 1887 which supervise to Implementation method of laws and regulations too. Because some believe in intensity of market approach, consequently ownership belongs to private sector and doesn't mediate except for vital cases of government.

On the other side, it was looked at Market Approach badly until the Second World War consequently available industries were national and governmental at that time mainly.

Nationalism was designed in direction of delete of political forces and against private exclusiveness and seemed as economic development stimulus. But in recent 50 years, Europeans went to American viewpoint.

Standard-setting authority will be private in America under such condition actually and international standards make gradually European accounting standards is changed and or the countries with the same course of action (policy) give up legislator form and change in the form of private sector standards.

## **2- Political - additional, Theoretical - scientific viewpoint**

Considering that account environment is base on Regulatory Approach a so standard-setting includes private sector, how Standard-setting Board especially FASB should be considered to collect and performance of accounting standards? Generally there is tow viewpoints in this connection:

Political- additional and theoretical - scientific viewpoints

### **2-1) political – additional viewpoint**

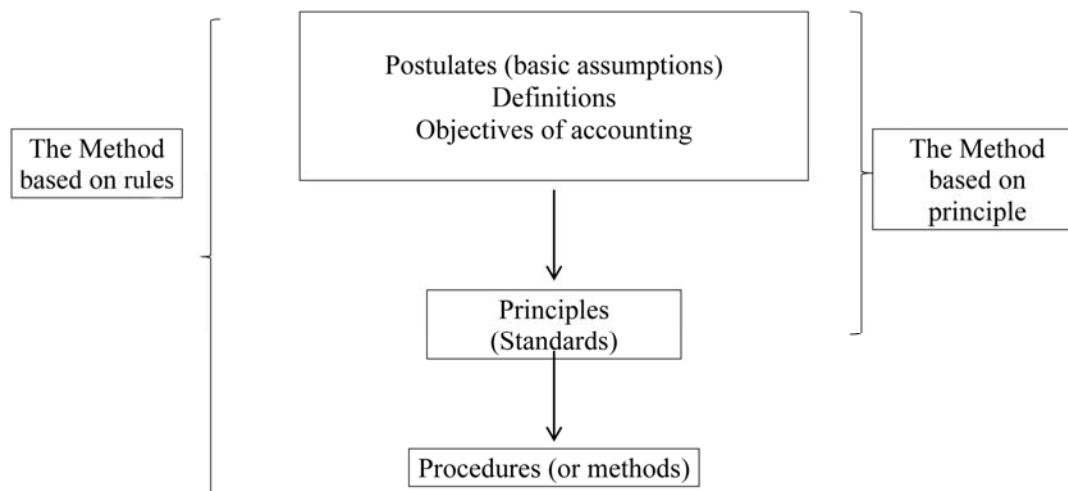
The set of accounting standards include important economic results and with theirs set, same group profit and same group loss. Consequently, process of Standard-setting is affected by political aspects and beneficiary persons like government, inventors, and managers try to apply their view in this process effectively and thereby get a lot of profits.

Supporters of political- additional viewpoint look at political process of standard enactment and look at accounting standard as parts of law. According to this viewpoint, FASB should be affected by policy not only for creating standards but also for their survival. Dale L.Gerboth, one of authorities, states that "political process of accounting legislation is not only unavailable but also fairly, because in a democratic society only political institution and organization can apply their instructions." Also he believes that "when success of decision-making process is depended on confidence of society, these political problems can be important instead of technical problems and in face to contract among adverse profits must ask for compromise and agreement instead of financial answer."

If an accounting standard seems as part of law, that time policy will be existed unavailable. A Standard-setting Board must be informed from political condition in these positions. It can't examine that whether a design is true theoretically and is supported by experimental reason or not?

## 2-2) Theoretical- Scientific viewpoint

On the other hand, theoretical – scientific viewpoint is based on theoretical ad experimental reasons in support of accounting standards and what is the focus point is not political or legal power but the power of reason is contracting of people. In this viewpoint is emphasizes on use of Syllogistic Method in Standard-setting and use of positive Method. (Figure 2)



**Figure 2:** Syllogistic approach in Theoretical – scientific viewpoint, the Method based on principle and rules.

In practice, two viewpoints are used. Use of scientific viewpoint is the first step and following should be considered political and economic process. In fact, structure of FASB and advantages of methods arising of its process is the reality of accounting environment as discussed by supporters of political- additional viewpoint.

## 3- Strategies for regulation of laws and regulations

Selection of suitable strategy by collectors will be an actual response to adverse of Regulatory Approach. In practice, there are different strategies such as:

1. **Command and control:** In this strategy, regulators of law and regulations determine carefully which activities are acceptable and which activities should not be done and heavy penalty are considered to offenders.
2. **Self -regulation:** This strategy is used in Broads and professional institutions, this kind of organizations enact a set of rules for their members. This is the same strategy which accounting job tries to keep it.

3. **Incentive-based regulation:** example of this strategy is giving financial encouragers.
4. **Disclosure regulation:** its example is revealing in regard to necessary information about articles of food. Of course revealing of financial inventories isn't belonged to this group.

#### **4- Execution of laws and regulations**

On of designed criticism is guarantee of execution. Of course, discussion of guarantee of execution is related to discussion about the effect of politics in accounting and influence on standard execution.

There are different methods in regard to standard execution that are classified to two methods that include compliance approach and deterrence approach.

From 1973 to 2002 has been emphasized on syllogistic action in America standard schematic process. This action from up to down place at GAAP, theoretical framework, standards and exclusive example and interpretations. Although it is possible that this approach be deleted for different reasons practically, and we use of reasoning, but it has been attempted that deduction is the main method and induction method remains exceptional.

In interpretational level has been used from this action for Standard-setting. In spite of this, there are many differences among theoretical framework; international standards and America have been more complex and detailed than international standards because of complex condition and special condition in it. In 2002, SOX code was passed which consequently American large firms was disagreed. This code forced SEC to test practicability of Standard-setting Method base on American principle. SEC suggested Standard-setting Method. This was the time that financial accounting standard committee dependent to America accounting instructor Board and firms like Pricewaterhouse Coopers emphasizes on base on principles. Finally, after different discussions that were made among SEC, FASB and other professional Boards in America, FASB concluded that accounting method has been rule base on regulations in America and it should direct to Standard-setting Method base on principles. In fact this law made clearness differences between two standards setting authorized and also made that is designed a new discussion in standard.

Investigation and comparison of America and the International Accounting Standards by various authorities, including the SEC, FASB, IASB and other accounting professional associations conducted generally two methods in the execution of the standards.

One of them is standard execution Principles-Based which is an acceptable method emphasizing on free action for professional Judgment and another method is regulation and execution of standard on rule based method that is an obstacle method which emphasizes on this matter that Standard-setting authority adjudges instead of work.

### **1. Standard-setting method Principles-Based**

#### **A- Definition:**

Principles are general statements which are supported by many and try to support of fact and impartiality and act like director.

Principles can't replace regulations and sometimes it is possible that a set of regulations utilize as director of applying principles but we need to adjudge for emphasizing monotone this regulations.

#### **B- Advantages:**

1. Large direction for different conditions.
2. Use of professional judgment.
3. Simplification of standards.
4. Preventing of alteration and showing actual activity of firm.

**C- Disadvantages:**

- 1.Reduction of contract capability (Reason of using regulations sometimes)
- 2.Factor of unavailability for enough reasons for presentation to legal courts (desire to reduction of responsibility at job)

**2. Standard-setting Method base on regulations**

**A- definition:**

It is an obvious decision-making Method, which there is no intensive doubt in relation to time and how use of it. Special direction has been presented by this method and sometimes it has been arbitrary and doesn't follow from special principles.

**B- Advantages:**

The most important advantages of it is increasing of capability among the firms.

**C- Disadvantages:**

1. It is used for circling of standards
2. It is made (causes) unnecessary of standards
3. Increases accountants
4. Make pale the professional judgment

Lease accounting, based on American accounting standards is the best example for presentation of the difference between these two methods. Use of 75% and 90% two conditions in " lease Accounting " in American standards is the sensible example Rules-Based and international accounting standard of lease which uses a professional judgment instead of presentation of percentage for determining kind of lease is the clear method Principles-Based.

Consequently international accounting standards used of the first method and American accounting standards used of the second method. So, from 2002 thereafter created this discussion that before designing of discussion syllogism and its hierarchy in Standard-setting should determine dominant viewpoint on this set. Standard-setting method base on regulations had showed its inefficiency practically and considering that legal necessity, FASB decided to use some positive aspects of Standard-setting method Principles-Based and bring near IASB viewpoints himself. SEC has allowed to outside (foreign) special firms that present American Stock Exchange, present their financial inventories based on international financial report standard from 2009 thereafter and there is no need to balance of financial inventories from international financial report standards based on America accepted accounting principles. So, SEC tries to determine a suitable time allow to American public firms to use of international financial report standards for providing of financial inventories. A set of these cases caused start of short tie and long time symmetric projects between IASB and FASB. This Approach caused that two important action happen. Firstly, discussion of symmetry of these two authorities it means that America doesn't like to translate international financial report standards text carefully and present in America and another important point is that even though it seems apparently that problem has been solved but the differences was deeper than this and finally, FASB was connected to international accounting standards. Because with the lapse of time from starting of important projects like identification of income and common theoretical framework hasn't gotten final any result. (Up to now a suggested text has been published in relation to qualitative properties and first introduction in relation to the personality of report in relation to theoretical framework project and two first introduction in relation to identification of income).

In last change, FASB published two new standards in relation to mix and minority shared that in spite of it be near to international accounting standards, in some cases differences from international financial report standards. So, manager of IASB is unsatisfied from current condition and says that at least 20 years is necessary

to result from symmetry discussion with America and says that finally it is possible that we reach everywhere that two authorities work on standard-setting along with each other.

## 5. Conclusion

Free Market Approach isn't a suitable approach for enactment accounting standards because of asymmetry information and free riding and other reasons that exist and the fall of market is witness of this matter. In contrast, Regulatory approach is more suitable choice for enactment of laws and regulations and establishment of SEC has been too in 1934. So, there is 3 types of regimes of accounting standard enactment that two cases of it is private and one case of it is governmental. The first group include the countries that accounting job is responsible for standard-settings (for example, it can be refer to Canada, Hong Kong, Newland and Taiwan), The second group includes the countries that independent group with help of job spread accounting standards (America, England are of this type) , In fact the second group has been derived of firs group as America experience presents this matter. The third group includes the countries that in their government are responsible for enactment of accounting standards (which obvious example of it is Australia, China, France and Malaysia). Some of these countries like Australia is derived of the first group. Self-regulatory strategy is true of two first groups and in the third group, laws and regulations and spread by government laws monotonously. Of course international standards has made that the third countries are desired to method of the first and the second groups. In relation to set and standard execution as referred must be considered syllogistic and scientific approach and so standard-settings must be made in direction of increasing of quality of decision-making and reduction of informational asymmetry. As professor May and Sandem say that "Social welfare resulting from accounting reports has known obviously. As a result, It isn't surprising that say FASB is a political authority and consequently the process of choice of an acceptable accounting method accounts a political process. As a result, FASB must consider political aspects (for example social welfares) with theory and accounting researchers in his decision-makings ". It must be considered that different groups ask for accounting standards for their profits. If a standard has a converse effect on their profits, it is expected that each work for preventing of creating of the standard. Political- additional viewpoint looks at political the process of standards and looks at accounting standards as part of law. Based on this viewpoint, Standard-setting authorities consider politics not only for creating standards, but also for their survival and of course collect authority must be considered that doesn't change in to a political tool. In discussion of ex enactment laws and regulations, the best method, Standard-setting Principles-Based approach. Although it is possible some countries considering their special conditions, use of Standard-setting method based on regulations, but considering disadvantages of method based on regulations, these countries must try to provide necessary background for execution of Standard-setting method by a special program. Also IRAN needs a set of integrated and coordinated accounting standard corresponding to its special culture and condition and also must determine our method in standard-setting. (Principle follower or regulation follower), perhaps this isn't authentic that texts translate from England, Australia, Canada, America and International without regard to Standard-setting method and present as a standard or direction of applying.

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