



SFB/Transregio 266

## ACCOUNTING FOR TRANSPARENCY

### Research on Corporate Transparency Element 9: Optimal Reporting Standards

Joachim Gassen

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## Motivating question

Can theory tell us how to design optimal accounting standards?

## Intuitive Answer

No

But it can lead to a more informed discussion

## Why not? Meet the Arrow paradoxon

Consider three stakeholder groups and their preferences for three different accounting rules

Stakeholder Group	Historical Cost	Lower of Cost or Market	Fair Value
Equity Investor	(3)	(2)	(1)
Creditor	(2)	(1)	(3)
Manager	(1)	(3)	(2)

For a related accounting classic that shows that fineness is the only context independent concept for ranking information systems see Demski (TAR, 1973).

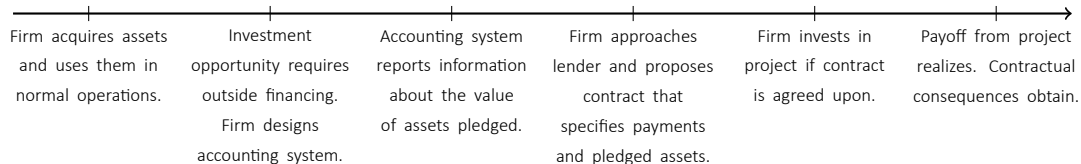
So:

- An accounting standard can only be considered to be “better” as an alternative standard when it generates finer information, meaning that the information partition of the former is a subset of the latter.
- And this ignores costs of information production

## OK. So what can theory do then?

- Given the heterogeneity of users and the heterogeneity of settings, it is impossible to derive normative accounting standards
- Setting standards is ultimately a political task
- However, theory can (again) help to high-light potential mechanisms that allow to identify how the attributes of efficient standards change conditional on specific settings
- This can help political decision makers to understand the trade-off between standards better

## An example: Göx and Wagenhofer (JAE, 2009)



## Endogenous impairment