
POSITIVE ACCOUNTING THEORY: A THEORETICAL PERSPECTIVE**¹ Tonye Ogiriki PhD & ² Emmanuel Atagboro PhD, MNAA****¹Associate Professor, Department of Accounting, ² Lecturer 1, Department of Accounting Faculty of Management Sciences, Niger Delta University, Amassoma, Bayelsa State, Nigeria***Email: tonyeogiriki@gmail.com, atagboroemmanuel@yahoo.com, atagboroemmanuel@ndu.edu.ng***ABSTRACT**

The study concludes through a thorough conceptual and theoretical analysis of the existing literature that the evolution of Positive Accounting Theory over the past several decades may be described as normal science, a term used by Kuhn (1996). Although scholars in PAT have been critical of one another's work, they have remained dedicated to the central paradigm for explaining accounting decisions (i.e., management incentives explain accounting decisions). According to PAT, empirical evidence should not be treated as conclusive. The relationship between theory and evidence is far more nuanced than that. As a result, contrary or unexpected data does not always mean a hypothesis should be abandoned. The importance of intangible assets and how they should be accounted for and reported has been emphasized in recent talks on fair value, mostly due to PAT's effect. Only when a new hypothesis appears that provides more explanation should the old one be discarded. Therefore, it is reasonable to switch between theories, and accounting expertise builds on itself over time.

Keywords: *Positive Accounting Theory, Accounting choices, Fair value, Intangible assets*

INTRODUCTION

Positive Accounting Theory (or "PAT" for short) is a school of thinking in the discipline of accounting that is relatively young yet is backed by empirical evidence. This theoretical stance is most closely associated with the writings of Ross Watts and Jerold Zimmerman in the years 1978 and 1979. These two articles were criticized in three different ways. It's not entirely agreed upon what PAT signifies. The study of accounting judgements and auditing techniques would be deemed PAT if the definition of accounting theory offered by Watts and Zimmerman in their 1986 book is used as the operational one. They make an effort to shed light on the economics-based empirical literature in accounting by detailing studies of accounting choice and studies of accounting based on the capital market. Ball and Brown (1968) popularized the term PAT by arguing that it embraced research into both capital markets and accounting choices.

There is an argument that positive accounting theory can explain how accountants actually do their jobs. This theory is founded on science and data and uses economics as an explanation. These assertions are dissected piece by piece and proven to be unsubstantiated in crucial ways. There are huge swaths of accounting that are not only not understood, but also not even observed. That research in the scientific realm is meant to provide technical standards or prescriptions is disregarded. Proponents of the theory only see a connection between economics and accounting on the periphery, not with the body of well-established economic theories. While the proponents of this theory claim to reject prescription, they yet support traditional accounting practices that rely largely on normative assumptions. The so-called "theory" is riddled with holes due to its many omissions, inconsistencies, and apparent contradictions.

Overview of Positive Accounting Theory (PAT)

Over the past four decades, the PAT program has been among the most consequential in the study of accounting. Accounting information and stock returns and prices, as well as the

management decisions that underlie these metrics, have been the subject of much empirical research. Of all the accounting journals out there, the Journal of Accounting and Economics has the greatest clout. Journal of Accounting and Economics; Journal of Accounting Research; Accounting Review; and Accounting, Organizations, and Society were chosen as the top four accounting journals by Brinn, Jones, and Pendlebury based on the opinions of UK academics (1996). Three of the most popular magazines include virtually completely positive articles. The sheer number of studies published in these two paradigms in leading accounting journals is one indication of PAT's prominence; another is its ubiquity in Ph.D. programs at institutions in the United States and elsewhere. The widespread implementation of PAT in the doctorate curriculum, the rising prominence of the journals it established, and the large number of academic publications produced are all indicators of PAT's influence.

Normative research in accounting had been the industry standard until PAT took hold. Researchers in the field of normative accounting theory had been focused on formulating those principles. Issues of identification and measurement have occupied the minds of these academics. The normative accounting community also frequently discusses the basis of financial statements (such as historical cost, market value, etc.). Does the fact that an entity was not involved in the underlying transaction affect whether or not it must record the effect of a change in market value? (Chambers, 1966; Ijiri, 1975; Littleton, 1953). PAT differs from normative accounting theory primarily in that it emphasizes the "is" rather than the "should" in business. By asking if the stock market could benefit from accounting information, PAT turned the conversation away from the measurement basis to use in accounting and toward whether or not management really uses that measurement basis.

The PAT is a paradigm change in the field of accounting studies. Watts and Zimmerman (1986) have used the similarity between their understanding of theory and the scientific understanding of theory to support and validate PAT. They have used numerous philosophers of science as examples to support their claim that their technique is scientifically sound and their view of theory to be consistent with that of science while also undermining the credibility of normative theory. Because of this, and the fact that PAT has fascinated accountants for 40 years, it's crucial to take stock of how well it's managed to mimic the hard sciences and where it's fallen short. The methodological stances of PAT should also be reviewed. It would be fascinating to compare the PAT growth trend to the scientific narratives that Watts and Zimmerman used to support their argument. This is so because a comparison of the two will help us learn where PAT is headed and where it is lacking in terms of methodology.

Since its inception, PAT has been met with a number of critiques. PAT proponents have been labeled a "PA cult" by authors such as Chambers (1993). Sterling (1990) said that PAT stifles advancement in the field of accounting because it ignores the necessity of assessing accounting practice in favor of focusing on the good aspects of the field and its practitioners. In addition, Sterling (1990) came to the conclusion that it was doomed to fail. Whittington (1987) defended the usefulness of normative accounting theory and criticized PAT for its lack of methodological openness. Neu (1997) provided an unfavorable critique of PAT. Sue (1997) claims that using PAT allowed scientists to focus on the information that was most useful to their studies. Hall (1997), in contrast to Sterling (1990), argued that PAT does have potential benefits. Deegan looked on how PAT caused significant feelings among faculty (1997). Scholars in several fields were either intrigued or repulsed. When Milne tried to explain a company's social disclosures using PAT, he failed (2002).

Positive Accounting Model

The first step in PAT was to analyze the underlying assumptions of conventional accounting advice from the 1960s. There were two different empirical investigations. Ball & Brown (1968), Beaver (1968); McNichols & Manegold (1982), to name a few are just a few of the authors who have studied the effects of fluctuations in accounting profit figures on stock prices (1983).

Earnings are a good indicator of other factors that affect company value, such as cash flow and risk, as shown by the research results. This went against the assertions of the normative accounting literature, which, according to Watts and Zimmerman (1986), maintained that accounting profit statements were meaningless since they were derived from distinct value bases. Several researchers have attempted to tell the no-effects and mechanistic theories apart: Kaplan and Roll (1972), Sunder (1973, 1975), Ricks (1982), and Biddle and Lindahl (1982).

The research' results were inconclusive and failed to favor any of the contending hypotheses. The theoretical foundations for these studies are the Efficient Market Hypothesis (EMH) and the Capital Asset Pricing Model (CAPM). Additionally, it was presumed that there were no expenses associated with contracting. Studies have called into question the assumptions underlying normative prescriptions from the 1960s, including (a) the existence of a unique source of information about a company, (b) the effectiveness of earnings numbers because they were not prepared according to a single basis, and (c) the possibility of misleading the stock market through the manipulation of the earnings number through accounting choices. Data analysis shows that these presumptions are not representative of reality. Since the EMH assumes competition, it follows that there must be some sort of informational hierarchy. Information releases by management and analyst interviews with business people are two alternate ways to learn about the company. Even if profits are not generated on a single basis, the correlation between unanticipated earnings and anomalous rate of return demonstrates that earnings represent elements essential to the valuation of stock. EMH and CAPM proponents went even farther, claiming that accounting tweaks couldn't be used to deliberately deceive investors. Changes to the books that affect cash flow are treated differently by investors than those that don't. The mechanistic explanation was thus not likely to accurately describe the universe.

As was mentioned above, preliminary research failed to adequately distinguish between the null-effects and mechanistic hypotheses. The no-effects hypothesis was not disproved as a result of this. Instead, the findings prompted the team to investigate the studies' methodologies and cast doubt on the pragmatic rationality of a key postulation (i.e., no contractual costs) used in the evaluations. Because of this, there has been a major discovery in the field of accounting. For a long time now, economists have accepted the fact that there are costs associated with entering into contracts (Coase, 1937). Studies in accounting no longer assume that there are no expenses associated with completing a transaction or obtaining new information. This finding paved the way for further research into the causes and consequences of accounting-related variance between businesses. This literature is based on the central concept that the business is a network of contracts, with accounting practices constituting an essential element of this web of agreements (Sunder, 1997).

Contracts may be drafted, monitored, and enforced with the use of accounting data (Sunder, 1997). This perspective on accounting emphasizes the role that contract terms have in determining a company's worth. As was expected under the EMH and CAPM paradigm, accounting is now more than just a formality. Accounting procedures may have an impact on cash flow to the contracting parties, as demonstrated by the elimination of the zero-cost assumption for contracts. Thus, it creates financial incentives for businesses to adopt more transparent accounting practices. Although this is a broad concept, early empirical studies of accounting decisions looked at how factors like earnings-based compensation programs, debt, and political process inside the corporation played a role. Multiple hypotheses, including those pertaining to political costs, debt-equity ratios, and incentive pay, are put to the test (Watts & Zimmerman, 1986). It is speculated that firms with bonus programs may change their accounting methods to maximize short-term profits. The debt-equity hypothesis suggests that companies with a high debt-to-equity ratio are more likely to prioritize short-term gains at the expense of their long-term viability. Accounting practices that push profits into the future are more common among large businesses, as predicted by the political cost hypothesis. Historically, researchers have used sample size as a proxy for how widely reported about a specific political

topic was in the media (e.g., Watts & Zimmerman, 1986). All these propositions assume non-zero contractual expenditures (Watts & Zimmerman, 1986). These presumptions are consistent with data, therefore, they may be safely made (Christie, 1990). The influence of mandatory and voluntary accounting adjustments on stock prices is another area of study (Watts & Zimmerman, 1986).

There has been a broadening of the original research of earnings management to look at earnings management in a variety of contexts. Examining the effects of major events on corporate profits both before and after the fact is one example of the kind of study that has been undertaken (like, management buyouts, DeAngelo, 1986; labour negotiation, Liberty & Zimmerman, 1986; import relief investigation, Jones, 1991; non-routine executive changes, Pourciau, 1993; and initial public offerings, Teoh, Wong, & Rao, 1998). Other research has looked at the correlation between corporate governance features and profit management (for instance, the effect of institutional ownership on research and development practices). Bushee, 1998: How independent directors' and the CEO's equity holdings influence earnings management. Accruals made at the discretion of management and the sway of the Big Six auditors at the time (Reitenga & Tearney, 2003). Becker et al. (1998), Big Auditing Firm Knowledge and Earnings Management, Francis, Maydew, and Sparks (2002), and (1999). Management of revenues and the fees auditors demand for auditing and other services, According to Krishnan (2003). Independent directors and an audit committee's impact on irregular costs (Frankel, Johnson, & Nelson, 2002). Board of Director Characteristics and Political Conservatism (Peasnell, Pope, & Young, 2005; Ahmed & Duellman, 2007).

Furthermore, some research has analyzed the thinking behind conservative accounting practices (Watts, 2003a, 2003b). In contrast, studies that focus on the accounting industry's relationship to the stock market have grown in recent years to probe the value significance of accounting figures. The pursuit of standardization motivates most capital-market-oriented accounting research (Barth, Beaver, & Landsman, 2001). The value-relevance of fair value is a topic of study that has been applied to more than only the financial markets (AAA Financial Accounting Standards Committee, 2005 & Landsman, 2007). Accounting numbers created in compliance with a wide range of Generally Accepted Accounting Principles have been empirically researched recently for their value relevance (Morais & Curto, 2009).

Positive Accounting Theory and Accounting Practice

The use of PAT has improved our comprehension of many events and problems in accounting. It has, for instance, provided useful information about the connection between accounting figures and stock takings and the incentives for financial reporting provided to management. Even so, it has made only a little impact on actual accounting procedures. Since its inception hundreds of years ago, accounting has changed gradually due to the cumulative effects of a wide variety of circumstances (Edwards, 1989). The financial markets are only one area where the value-relevance of fair value has been studied (AAA Financial Accounting Standards Committee, 2005; Landsman, 2007). Recent empirical enquiries have looked at the value significance of accounting figures calculated using a wide range of generally accepted accounting principles (Like German GAAP, IFRS, and US GAAP; Morais & Curto, 2009).

However, there is now empirical evidence for and against fair value measurement. According to studies cited in the literature on value relevance, the fair market value of an item may be relevant to value under certain situations (Landsman, 2007). However, several experts in the field of accounting have suggested that fair value is an overly subjective metric, especially when based on model-based valuations. Management manipulates reported earnings for their own ends, as evidenced by the PAT literature (Watts & Zimmerman, 1986). Recently published research confirms that management adjusts fair value estimations. Benston (2006), for instance, offered proof of Enron's rather broad use of fair value and contended that management's erroneous application of the metric led to the company's eventual collapse. Byrne, Clacher,

Hillier, and Hodgson (2008) found that while calculating the fair value of pensions in the United Kingdom, multiple discount rates, salary growth rates, predicted returns on equity, discount rate spreads, and equity return spreads are employed. Furthermore, they speculate that the divergent assumptions are not based on basic economic principles but rather on management's motivations to inflate income from retirement pension plan assets. In addition, they speculate that the discrepancies in assumptions are not based on basic economic principles but rather on management's motivations to inflate income from retirement pension plan assets.

The intangible assets debate, which considers whether or not intangibles developed in-house should be recorded as assets, has also benefited from the PAT literature. According to studies cited in the "value relevance literature," it is important to include information about intangible assets in financial statements. Based on these results, it has been suggested that the present method of accounting for intangibles be modified (Lev & Zarowin, 1999; Lev, 2001). Moreover, PAT results have shown instances where management is likely to tamper with profitability. The issuance of shares, the breach of financial covenants (Healy, 1985), and the expectation of lower-than-expected profits for the current year are all problems Burgstahler and Dichev (1997) identify. Tong, Rao, and Teoh (2003). According to (Pourciau, 1993). Financial statement auditors have an ethical and legal responsibility to determine if there is a possibility of fraud or serious misrepresentation in a company's financial statements (e.g., IAASB, 2009). Observations like this could aid the auditor in spotting instances of probable earnings manipulation.

The field of accounting that focuses on the stock market has grown to scrutinize the value significance of accounting figures. The pursuit of standardization motivates most capital-market-oriented accounting research (Landsman, 2007). The value-relevance of fair value is a topic of study that has been applied to more than only the financial markets (Landsman, 2007). Accounting statistics created in line with a wide range of generally accepted accounting principles (GAAP) have been empirically studied recently for their value relevance (Like IFRS, Clarkson et al, 2009).

CONCLUSION/ IMPLICATION

This study suggests that the progress in PAT during the past few decades may be best described as normal science, as defined by Kuhn (1996). While academics in the field of PAT have stayed dedicated to the underlying paradigm for analyzing accounting choices (i.e., organisation inducements illuminate accounting decisions), they have been fruitfully precarious of the works of their peers. According to PAT, empirical evidence should not be treated as gospel. Instead, theory and facts interact in subtle and nuanced ways. Therefore, it is not necessary to immediately dismiss a hypothesis if new data emerges that conflict with it. Only when a new hypothesis comes up that can explain things better should the old one be discarded. This implies that there is a reasonable basis for selecting one theory over another, and that accounting knowledge is, in fact, cumulative.

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