

# Positive accounting theory flashcard



**ASSIGN  
BUSTER**

Positive Accounting Theory • Sometimes abbreviated as PAT • Explains and predicts accounting practice • Does not seek to prescribe particular actions • Grounded in economic theory • Focuses on the relationships between various individuals involved in providing resources to an organisation (agency relationship) • Owners and managers • Managers and debt providers

Positive Accounting Theory • Assumptions of PAT All individual action is driven by self-interest • Individuals will act in an opportunistic manner to increase their wealth • Notions of loyalty and morality are not incorporated within the theory • Organisations are a collection of self-interested individuals who agree to cooperate

Positive Accounting Theory • PAT predictions • Organisations will seek to put in place mechanisms to align the interests of managers of the firm (agents) with the interests of the owners (principals) • Some of these mechanisms rely on the output of the accounting system

PAT – Practices to Be Explained Why do firms prepare accounting reports? • Why are those reports so conservative? • What motivates the choice amongst accounting method alternatives? • Why firms lobby for/against accounting regulations? \*\*PAT CAN PROVIDE US WITH SOME ANSWERS\*\*

Positive Accounting Theory • Research that applies PAT usually adopts either an efficiency or an opportunistic perspective • Efficiency perspective of PAT Researchers explain how contracting mechanisms can be put in place up front with the objective of minimising agency costs, ie the costs associated with assigning the decision making processes to an agent • Referred to as ex ante perspective i. e. before the fact, what things are introduced up front to try and minimize future agency costs • Efficiency perspective also argues accounting practices adopted by firms are adopted because they best reflect the underlying financial

performance of the entity Positive Accounting Theory Opportunistic perspective of PAT • Considers opportunistic actions that could be taken once various contractual arrangements have been put in place • Assumes managers will opportunistically select accounting methods to increase their own personal wealth • Is also known as ex post meaning after the fact because it considers opportunistic actions that could be taken once various contractual arrangements have been put in place PAT in Summary Selection of accounting methods can be explained by either efficiency or opportunistic arguments • Accounting methods can impact on cash flows associated with debt and management compensation contracts • These effects can be used to explain why particular accounting methods are used • The use of particular accounting methods can have conflicting effects [pic]