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ACCOUNTING THEORY

A MODERN SYNTHESIS

To make easier to master the material, this book has been equipped with:

- Learning Objectives
- Summary
- Exercise
- Cases

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FOREWORD

All praise and gratitude are due to God Almighty for His grace, guidance, and mercy throughout the long journey of writing this book. Without His help, patience, and strength, this work would not have reached completion. I am deeply thankful for every opportunity, challenge, and lesson that shaped the ideas in these pages.

I also offer my sincere appreciation to the people who have supported me in many ways. To my family, thank you for your love, prayers, and understanding when time and energy were devoted to study and writing. Your encouragement made the work lighter, especially during moments of doubt and fatigue. To my academic colleagues and mentors, thank you for the discussions that sharpened my thinking, the feedback that improved the clarity of my arguments, and the shared commitment to learning that kept this project moving forward. I am grateful as well to students, peers, and friends who asked questions, offered suggestions, and reminded me that good writing begins with careful listening.

This book was written with a simple aim: to present accounting as a meaningful way of describing and communicating economic activity. Accounting is often seen as a set of technical rules, yet behind every rule there is a purpose, a judgment, and a tradeoff. The chapters invite readers to look beyond formulas and procedures, and to understand why accounting numbers take the form they do. They explore how reporting choices shape what becomes visible, what becomes comparable, and what becomes accountable. Along the way, the book connects measurement, estimation, disclosure, auditing, and standard setting to real problems faced by organizations and the people who rely on reports.

I hope this book offers useful contributions and practical benefits to many parties. May it support students who are building strong foundations, lecturers who are developing learning materials, and researchers who are exploring how accounting works in society. I also hope it helps practitioners, including accountants, auditors, managers, and analysts, by strengthening professional judgment and improving communication with report users.

Finally, may it be valuable for regulators, standard setters, investors, lenders, and other stakeholders who depend on credible information for oversight and decision making. If this book can encourage clearer understanding, better questions, and more responsible practice, then its purpose will be fulfilled.

Bandung, September 2026

Dr. Hisar Pangaribuan, SE., MBA., AK., CA.

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CHAPTER 1

INTRODUCTORY OVERVIEW: WHY ACCOUNTING THEORY EXISTS

Learning Objective

After studying this chapter, we are able to:

a. Define what “theory” means in accounting (explanation vs prescription)
b. Elaborate the big questions: measurement, communication, accountability
c. Explain what counts as a “good” theory (coherence, usefulness, testability, ethics)
d. Understand how this book is organized (four-part roadmap)

SUMMARY

Accounting theory exists because accounting is more than a technical routine. It is a way of thinking about how economic activities are measured, communicated, and used to hold people and organizations accountable. In this chapter, theory is introduced as an organized framework that helps explain why accounting practices look the way they do and guides judgments about what accounting should do. These two roles, explanation and prescription, are closely connected rather than sharply separated.

The chapter highlights three recurring questions. Measurement asks what accounting numbers represent and what their limits are. Communication asks how accounting information is produced, interpreted, and trusted by users. Accountability asks who is responsible, to whom, and on the basis of which numbers. Together, these questions show why accounting choices matter and why they are often contested. The chapter also explains what makes a good accounting theory. It should be coherent, useful, open to testing, and ethically aware, recognizing that accounting

CHAPTER 2

ACCOUNTING AND THE WORK OF ACCOUNTANTS

Learning Objective

After studying this chapter, we are able to:

a. Understand accounting as a social and economic practice (not just technique)
b. Understand professional roles: preparers, auditors, analysts, regulators, users
c. Explain accountability and stewardship as organizing ideas
d. Elaborate boundaries of accounting (what accounting includes/excludes)

SUMMARY

This chapter explains accounting as a social and economic practice, not just a technical skill. Accounting works because it creates shared meanings that allow economic activity to be understood, compared, governed, and trusted. By turning complex organizational life into recognized categories, numbers, and narratives, accounting supports coordination and decision making across managers, investors, regulators, and the public.

The chapter examines the professional roles that make this system work. Preparers translate business activity into reports through judgment and classification. Auditors provide credibility and assurance where direct verification is impossible. Analysts interpret and extend accounting information for valuation and forecasting. Regulators and standard setters define rules and enforcement, while users rely on accounting to evaluate performance and stewardship. These roles are different, but they depend on one another.

CHAPTER 3

APPROACHES AND CLASSIFICATIONS OF ACCOUNTING THOUGHT

Learning Objective

After studying this chapter, we are able to:

a. Understand normative approaches (what should be)
b. Explain positive approaches (what is / why it happens)
c. Understand interpretive approaches (meaning, context, institutions)
d. Elaborate the critical/post-structural approaches (power, discourse, deconstruction)
e. Understand method map: conceptual, archival, experimental, field, analytical, causal designs

SUMMARY

This chapter maps the main approaches used to think about and study accounting, showing that accounting theory is not a single viewpoint but a collection of perspectives that ask different kinds of questions. Normative approaches focus on what accounting should do, developing principles and frameworks to guide reporting choices based on stated objectives. Positive approaches focus on what accounting is and why particular practices emerge, emphasizing explanation, incentives, and testable claims about behavior. Interpretive approaches shift attention to meaning, context, and institutions, treating accounting as a language whose numbers and categories require interpretation within social settings. Critical and poststructural approaches go further by examining power, discourse, and taken-for-granted assumptions, showing how accounting participates in shaping what is seen as legitimate, normal, or true.

CHAPTER 4

ACCOUNTING AS A FIELD OF KNOWLEDGE AND A LANGUAGE

Learning Objective

After studying this chapter, we are able to:

a. Understand accounting as representation: models, symbols, conventions
b. Explain the reporting objective(s): decision usefulness vs stewardship
c. Elaborate conceptual frameworks: purpose, strengths, and limitations
d. Explain the key qualitative characteristics (relevance, faithful representation, etc.)
e. Understand the measurement bases overview: cost, current value, fair value, mixed models

SUMMARY

This chapter explains accounting as a field of knowledge and as a language used to represent economic reality. Accounting does not mirror the world directly. It builds models that simplify complex activities into symbols, categories, and numbers that can be communicated and compared. These representations depend on shared conventions, which function like the grammar of accounting, allowing users with different information and interests to understand the same report. The chapter then turns to reporting objectives. Decision usefulness emphasizes information that helps users assess future prospects and risk, while stewardship emphasizes accountability for how entrusted resources have been managed. These objectives overlap but point to different priorities in measurement, disclosure, and evaluation.

CHAPTER 5

THE UNIT OF ACCOUNT AND MEASUREMENT PROBLEMS

Learning Objective

After studying this chapter, we are able to:

a. Understand the entity, time period, unit of account, and boundary choices
b. Elaborate recognition vs measurement: when to record, how to value
c. Explain uncertainty, estimation, and judgement
d. Explain the capital maintenance concepts and consequences (financial vs physical)
e. Explain “one-sided” vs “balanced” views in measurement compromises

SUMMARY

Accounting turns a complex economic world into something manageable by drawing boundaries. Chapter 5 explains how choices about the reporting entity, time period, unit of account, and recognition determine what becomes visible in financial statements and what does not. These boundaries are not neutral; they shape how performance, position, and accountability are understood. Closely linked is the distinction between recognition and measurement. Recognition asks when something enters the accounts, while measurement asks how it is valued. The two can diverge, which explains why some economically important items are disclosed but not recorded, or recorded in ways that only partially reflect their significance.

CHAPTER 6

COMMUNICATION, DISCLOSURE, AND USERS

Learning Objective

After studying this chapter, we are able to:

a. Understand financial reporting as communication (signals, narratives, persuasion)
b. Elaborate information economics and disclosure incentives
c. Understand behavioral limits of users (processing constraints, bias, heuristics)
d. Elaborate visuals, non-financial information, and integrated reporting concepts
e. Understand materiality and comparability in practice

SUMMARY

This chapter explains financial reporting as a form of communication rather than a neutral technical output. Reports are written by organizations, read by diverse users, and interpreted within settings shaped by incentives, institutions, and credibility. Numbers, narratives, and disclosures work together as signals in environments where insiders know more than outsiders. Reporting therefore involves signalling, explanation, and persuasion, not just measurement. Information economics helps explain why disclosure exists and why it is strategic. Adverse selection and moral hazard create demand for reporting, assurance, and regulation, while voluntary disclosure is shaped by benefits such as reduced information risk and by costs such as competition, litigation, and political exposure. Mandatory disclosure responds to market failures but also changes behavior in unintended ways.

CHAPTER 7

THE ACCOUNTING EQUATION, DOUBLE ENTRY, AND STRUCTURAL CONSTRAINTS

Learning Objective

After studying this chapter, we are able to:

a. Understand the accounting equation reconsidered (what it assumes)
b. Explain double entry as an organizing device (strengths and blind spots)
c. Explain the "overworked" balance sheet: what gets forced into it
d. Understand non-monetary and alternative measurement possibilities
e. Elaborate system design constraints: internal controls, auditability, verifiability

SUMMARY

This chapter takes a careful look at the accounting equation and double entry, not as neutral techniques, but as powerful organizing conventions with built-in assumptions and constraints. The accounting equation structures accounting around balance and duality, linking resources to claims, but that balance reflects classification and measurement choices rather than economic truth. Double entry strengthens reliability through self-balancing records and internal checks, which explains its durability and scalability. At the same time, it narrows attention to what fits debit-credit logic and a single monetary unit, creating blind spots for many drivers of modern performance.

These limitations become most visible in the "overworked" balance sheet, which is asked to serve stewardship, valuation, solvency, and performance analysis all at once. As a result, contested measurements and hard-to-verify items are often forced into it, while others remain excluded. The chapter therefore explores non-monetary and alternative

CHAPTER 8

POSITIVE ACCOUNTING: MARKETS, INCENTIVES, AND ACCOUNTING CHOICE

Learning Objective

After studying this chapter, we are able to:

a. Understand why “accounting choice” matters
b. Explain efficient markets and information content (what accounting numbers “do”)
c. Explain earnings management as equilibrium behavior
d. Elaborate regulation shocks (e.g., revaluation rules) and behavioral responses
e. Understand the limits of “agreed conceptual frameworks” in practice

SUMMARY

This chapter introduces positive accounting by focusing on accounting choice and the incentives that shape it. The central idea is that accounting is not just about measuring reality, but about choosing among permitted methods, and those choices matter because accounting numbers influence contracts, markets, and perceptions of performance. Once discretion is acknowledged, reporting outcomes must be understood as the result of incentives operating within institutional and regulatory constraints. The chapter explains how accounting information functions in capital markets, using efficient markets as a benchmark. Accounting numbers affect prices mainly when they provide new, credible information, but real markets may process complex information imperfectly. As a result, accounting choices and presentation can have meaningful market effects, especially when earnings serve as focal points for expectations. Earnings management is then reframed as equilibrium behavior. It arises predictably when

CHAPTER 9

CONTRACTING, AGENCY, AND GOVERNANCE

Learning Objective

After studying this chapter, we are able to:
a. Understand principal–agent problems: moral hazard, adverse selection, monitoring
b. Explain accounting numbers in contracts: debt covenants, compensation, stewardship
c. Understand auditing as assurance and an institutional response to agency problems
d. Elaborate standards and enforcement as “rules of the game” (costs/benefits)
e. Explain the political economy of contracting outcomes (who gains/loses)

SUMMARY

This chapter explains accounting through the lens of contracting, agency, and governance. It starts from the principal–agent problem, where one party delegates decisions to another under asymmetric information. Moral hazard arises when effort or actions cannot be observed after contracting, while adverse selection arises when agents hold private information before contracting. In both cases, accounting numbers matter because they provide standardized, publicly verifiable signals that support monitoring and enforcement.

The chapter shows how accounting numbers are written directly into contracts. Debt covenants use accounting measures to protect lenders and shift control rights when risk rises. Compensation contracts use earnings and related measures as scorecards, balancing incentives against noise and risk sharing. Stewardship highlights accounting’s older role as a discipline of accountability, emphasizing verifiability and evidence over pure valuation relevance. Auditing is then introduced as an institutional response to agency problems. Audits do not guarantee truth, but they reduce

CHAPTER 10

STANDARD SETTING, LAW, AND THE POLITICS OF RULES

Learning Objective

After studying this chapter, we are able to:

a. Understand standard-setting institutions and legitimacy
b. Explain accounting as delegated “law-like” infrastructure
c. Explain conceptual frameworks: why they persist (and why they disappoint)
d. Explain harmonization vs local relevance (comparability tradeoffs)
e. Explain enforcement, compliance, and unintended consequences

SUMMARY

This chapter examines accounting standard setting as a form of institutional governance rather than a purely technical exercise. Standards derive their force from legitimacy, which rests on legal backing, fair and transparent procedures, and the belief that rules produce acceptable outcomes. Because accounting rules shape contracts, enforcement, and public accountability, standard setting operates as delegated, law-like infrastructure, even when the rules are written by professional bodies rather than legislatures.

The chapter explains why conceptual frameworks persist. They provide a shared language, justify delegation, and offer continuity across standards, yet they often disappoint because they cannot resolve deep tradeoffs between relevance and verifiability, stewardship and valuation, or global consistency and local context. These tensions reappear most clearly in debates over harmonization. International standards improve comparability,

CHAPTER 11

INTERPRETIVE, CRITICAL, AND POSTSTRUCTURAL PERSPECTIVES ON ACCOUNTABILITY

Learning Objective

After studying this chapter, we are able to explain:
a. Accounting as a “regime of truth” and a social technology
b. Power, discourse, and what reports make visible/invisible
c. Deconstruction and reading accounting texts critically
d. Ethics, public interest, sustainability, and plural accountability
e. Implications for education, practice, and research agendas

SUMMARY

This chapter shifts attention from accounting as neutral measurement to accounting as a social practice that shapes what counts as truth, value, and responsibility. Interpretive, critical, and poststructural perspectives view accounting as a regime of truth, where rules, professional authority, and audit procedures determine which statements are accepted as legitimate. Accounting numbers are therefore not just discovered; they are produced through institutional processes that define what can be said and who is authorized to say it.

The chapter explains how accounting functions as a social technology that makes some aspects of organizational life visible while rendering others invisible. Recognition rules, aggregation, and classification create standardized facts that support governance and control, but they can also

CHAPTER 12

CAUSAL INFERENCE IN ACCOUNTING RESEARCH AND EVIDENCE BASED POLICY

Learning Objective

After studying this chapter, we are able to explain:

a. Why causal effects are hard in accounting settings
b. Identification threats: endogeneity, selection, simultaneity
c. Research designs: experiments, natural experiments, quasi-experiments
d. "Why, not recipes": building reasoning discipline in inference
e. The road ahead: integrating theory, evidence, and accountability

SUMMARY

This chapter explains why causal inference is especially difficult in accounting research and why this difficulty matters for evidence based policy. Accounting variables are rarely assigned randomly. They are chosen, interpreted, and enforced within institutions where incentives, contracts, and expectations interact. As a result, reported numbers and real behavior often move together, making it hard to separate cause from coincidence.

The chapter reviews key identification threats. Endogeneity arises when accounting choices are shaped by the same forces that influence outcomes. Selection occurs when firms self select into reporting practices or regulatory regimes. Simultaneity appears when reporting and behavior are jointly determined within feedback systems. Measurement problems add another layer, since many accounting constructs are captured only imperfectly by proxies. Institutional change, cross regime differences, and data access

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Accounting theory can feel like a tug of war between tidy rules and messy reality. This book shows you why that tension is the point. It treats accounting as a language that models organizations, selects what counts, and turns complex activity into numbers and narratives that people can trust, debate, and act on. You will see how reporting objectives shape everything, from recognition and measurement to disclosure and materiality. Decision usefulness asks what helps users assess future prospects and risk. Stewardship asks what helps resource providers and society judge how well resources were managed and obligations were met.

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