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# Approaches and criticisms of positive accounting theory and its economic consequences

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**Abstract**
This paper describes early on positive accounting of theory, where is the theory to help explain and predict the accounting practice. The explanation is also complemented by research that supports and also underlies positive accounting theory that was carried out before and after an article in 1990 by Watts and Zimmerman. Positive accounting theory trying to understand how accounting practices are used by accountants in different situations and by different companies. To answer the origin of the concept of economic consequences, it is introduced a theory that is positive accounting theory.

**Keywords:** positive accounting theory, political cost, economics approach, the economic consequences

## 1. Introduction
The motivation of responsible managers' performance is as important for financial accounting as it is for providing information to investors. Therefore, accountants need to understand and appreciate the interests of management in preparing financial statements. When a new thought emerges which, when viewed in detail, can be seen the difference with investor decision-based theory and efficient market-oriented. Watts and Zimmermen 1978 [13] through their paper entitled toward a positive accounting standard published by the accounting of review which is introduced PAT which has shifted the paradigm of accounting research from normative to positive. Then in 1990 they expressed the hypotheses positive accounting of theory in which there was an explanation of bonus plans, breaches of debt covenants and political costs which became the basis of benchmarks in current accounting research.
Accounting of Theory sometimes gives confusion with the existence of normative or positive notions such as the theory described by Watts and Zimmerman in 1986 [14] about normative of theory in which attempted to explained which is information must to be communicate to the entire user accounting of information and such the accounting would be present to the user. The normative of theory will try explains information about what is accountant must be do on the process of presented financial of information to all user, and not explain what the financial of information actually contains and why that was happened. According to Nelson in Anis and Imam (2003) [1] normative of theory sometimes also called with a priori of theory (the cause of thing for effect something). A normative of theory not produced from the empirical research then it is produced in research on activities. Instead the purpose of the approach positive of theory trying to define how a financial information will be present and to communicate to all user accounting of information, with another explanation the approach of positive theory does not to providing give directives on proper accounting practices done, but to explained why the accounting practices reach its present form. In addition, empirical research needs to be emphasized in a positive theory approach to test whether in the literature accounting theory can explain the applicable accounting practice has been stated (Arif, 1999) [3].
Watt and Zimmerman (1986) [14] reveal that there are three basic reasons for a shift in the normative to positive approach, such as 1) in empirically testing the theory there is an inability of a normative approach, because based on a false assumption cannot be valid tested with empirical, 2) the normative approach will focused on the more prosperity individual of investors rather than of prosperity society in general, 3) suboptimal allocation of economic resources through a normative approach. Considering economic in system based on market orientation mechanism, the accounting of information can be a controlling tool to allocate economic of resources with efficient, then according to watt and Zimmerman which describe the normative approach is so simple and it is not provide strong a theoretical basis to analyzing accounting of theory. Then they develop a positive approach that applies in the specific scientific period (1970-present) to cover the weaknesses of this normative theory.

## 2. Literature Review
### Positive Accounting Theory
Positive accounting of theory develops along with the need and provides explanations and predictions of the reality of accounting

Practices that exist in public. The accounting phenomenon that is trying to be explained by positive accounting theory is observed based on review that cause an event to occur. In another sense, positive accounting of theory is to intend provide an explanation and prediction of the consequences which occur if the managers are faced with certainly choices. The Positive accounting of research was first conducted by William H. Beaver (1968) in publication of an article entitled "The Information Content of Annual Earnings Announcements" (Jensen, 1976: 4, 8) [7]. Further positive accounting theory recognized its existence when Watts and Zimmerman has publish his article entitled "Towards a Positive Theory of the Determination of Accounting Standards" in 1978. The article has made a positive accounting of theory as the dominant paradigm accounting of research empirically based qualitative and can be used to prove varian accounting technique or some method where used to currently or find new models for development accounting theory in the future. In this case, positive accounting theory try to explain or predict real phenomena and test them with empirical (Godfrey, el al, 1997 in Ghozali and Anis, 2007). Based on the plan bonus hypothesis, managers often behave in line with the bonuses given (Alfina, 2006). Therefore, management tends to carry out earnings management so that profit targets are met. Earnings management actions make earnings reporting tend to be optimistic or not conservative, so that earning conservatism is low. *Debt covenants hypothesis* predicts that managers want to increase profit and also asset to reduce the cost of debt renegotiation when company decide later debt agreement. In the *debt covenant hypothesis*, the level of profit reporting conservatism will decrease because managers tend to increase profits in order to obtain *potential* loans from creditors. The level of conservatism in reporting earnings based on the debt covenant hypothesis can be explained by the debt / equity hypothesis which is a limitation of the debt covenant. In the political cost hypothesis explained that company judged more sensitive to the political cost of the smaller companies. Political costs that arise because of the conflict of interest that occurs between the manager and the government, then the company being involved and responsible for the social interests of the community. One of the government policies for this is the obligation to pay taxes. The greater the level of income or sales of the company, the higher the tax to be paid. Therefore, to avoid high taxes, management will tend to report low profits, so it can be said that there is conservative earnings reporting (Sari and Adhariani, 2009) [9].

**Research that Supports Positive Accounting Theory**

Many researchers have proven the three hypotheses put forward by Watt & Zimmerman, while the researchers are Scott (2000) [10]:

a. Healy, 1985 with the bonus planning hypothesis, which produces evidence that managers who base their bonuses on net income are reported systematically using accrual accounting policies for reporting income so that they can maximize bonuses.
b. Sweeney, 1994 with the debt covenant hypothesis, produced evidence that companies often violate debt covenants in the form of maintaining working capital and shareholder equity.
c. Jones (1991) reviewed firm changes to reduce reported net income for import relief. Granting import concessions to companies is unfair because they are influenced by foreign competition, partly a political decision.
d. Lev (1979) in the bonus-debt convenant hypothesis, there is a tendency for managers to be opportunistic by saving bonuses and ignoring changes in debt covenants when the expected market efficiency reacts negatively.

**Research that criticizes positive accounting of theory**

There have been many articles critizing and evaluating positive accounting of theory that have been pusblished since 1982. In this case the critics are usually grouped into three groups, namely (Lawrence AB, 1992) [4]:

1. Criticism of research techniques or methods. In this case it is stated that the writings on positive accounting that have been surveyed fail to describe the model of multi-person/human as a whole the same for multi-period/period as a whole and is weak in both strategies, namely: in consideration and theoretical approaches that may be useful in theory development formal.
2. Criticism of philosophy is based more on the emphasis that Watts & Zimmerman give positive/normative boundaries. Watts & Zimmerman did not rely on the other philosophical arguments of science in their first writings to support the methodology they were developing. Watt & Zimmerman considers that the social world and its structure can be viewed separately from the individual being studied, this is not objective because it is impossible for the researcher to be separated from the object under study.
3. Criticism of accounting research based on economics.
    a. Individual methodology, depicted that every social phenomenon as a consequence of decision making by individuals. In short, individuals make decisions but do not implement them. When the committee sets the standards, the director makes the decisions, the individual methodology says that it is a group decision with an explanation of the decisions made by each member on the committee.
    b. The neochisic approach by maximizing the hypothesis because the assumption or assumption of maximization is only one of the many assumptions needed in neochial theory, under this claim that every individual makes a decision, the subject is subject to limitations that exclusively maximize the benefits of each person.

**Economic Consequences**

The concept of economic consequences originally appeared in an article written by Stephen Zeff (1978) under the title "*The Rise of Economic Consequences*." Zeff defines of economic consequences as "*impact of accounting reporting the making a decision behavior from the businesses, governments, and creditors involved*". According to Zeff, intervention from third parties greatly complicates the preparation of accounting standards. Zeff explains the standard setter agency responses to a range of interventions such, are expanding representation in the standards bodies. Apart from the implications of efficient market theory, making choices about accounting policies of course also have economic consequences for various users of financial statements. With the existence of economic consequences whose conditions make it increasingly difficult to determine accounting standard, thus requiring a balance between political and accounting consideration.

An important objective positive accounting of theory as to describe early is to provide an explanation and prediction of real accounting practice, relating to individual behavior in choosing accounting methods that can achieve maximum usefulness. To appreciate the concept economic of consequences, therefore that is necessary to understand the interest of management (Scott, 2009: 296) [11]. Positive accounting of theory does not directly provide a determination of the accounting policy choices that suit the needs of the company. For the company. In this explanation, if the accuracy is reviewed from the management side, the selection of accounting policies will be easier. Management is more flexible in choosing accounting policies for the company because of the changes that occur

## 3. Conclusion

PAT does not imply that the company's accounting policy choices should be specifically explained. Instead, it will usually be more efficient if there is a set of accounting policies that management can choose from. The presence of positive accounting theory has made a significant contribution to the development of accounting, namely generating systematic patterns in accounting choices and providing specific explanations for these patterns, providing a clear framework for understanding accounting, showing the main role of contracting costs in accounting theory, explaining why accounting is used and provide a framework for predicting accounting choices, encouraging relevant research where accounting emphasizes the prediction and explanation of accounting phenomena.

From the PAT perspective, the economic consequences of accounting policies are not difficult to understand. From an efficiency perspective, the available set of policies affects the flexibility of the firm. From an opportunist perspective, management's ability to choose accounting policies for its own benefit is also affected. The description of this PAT emphasizes how accounting theory can explain and predict phenomena based on real events in the accounting world. The change from a normative approach to a positive approach in accounting research is due to the following reasons: (1) in empirically testing the theory the normative approach cannot be done; (2) the normative approach focuses more on investors, and (3) the normative approach does not allow the allocation of capital in the stock market. Currently positive research is dominated by accounting practices associated with decision making by investors. Many researchers use PAT to empirically prove accounting practices such as Ball and Brown, Heally, Jensen and McKling and many more. As stated by Watts and Zimmerman in Scott (2015: 284) about PAT, positive accounting theory (PAT) is related to predicting actions such as the choice of accounting policies by companies and how companies will respond to new accounting standards that are being proposed. From the description above, it can be argued that PAT emphasizes whether the accounting theory put forward in the accounting literature can explain the accounting practices carried out and predict the causes of the phenomena that are currently happening and their effects in the future.

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