To Our Readers

For various reasons, corporate disclosures have become a topic of focus during the past few years. As can be expected, there are differing points of view as to what the real need of such disclosures is. The usual defense is to say that disclosures are the requirements of transparency towards shareholders. That last word has now been extended by proponents of corporate governance to include stakeholders, by which is meant practically everybody.

Is it necessary then, to increase the level of disclosures ad infinitum? No, argue some, basing their response on the number of accounting standards issued by the various authorities and the number of disclosures they mandate. That is sufficient, they say, quite overlooking the fact that the number of standards is not limited to the current number, and as more are issued in various parts of the world, and as the need for translation of annual financial statements from one set of standards to another grows in response to the need to globalize business, the number of disclosures also increases. That this also creates a huge cost of compliance for the corporates, often gets overlooked.

How would one then apply Occam's razor? What is the way to say that this much is necessary and sufficient? The answer just might come from Legitimacy theory. As some have argued, corporate annual reports can at least be viewed as a partisan writing of history, a means through which corporates seek to define themselves and their place in the affairs of the world.

Legitimacy theory is a rather simplistic theory that relies upon the concept of a 'social contract' between the organization and the society at large. The social contract is to the extent that society will legitimize the organization of social expectations are complied with. According to legitimacy theory, disclosures might be made to show that the organization is conforming to community expectations. On the other hand, disclosures might be designed in such a manner as to influence community expectations. A rather obvious example is the tendency of the stock market to react to anything that is published in a company's balance sheet.

Certainly, there is a role of the media here. Researchers have argued that media might itself (sometimes unknowingly) tailor a company's public disclosures in such a way while reporting that a basic desire to conform becomes changed to a desire to influence community expectations. An important point here is that social expectations are dynamic, and as at least one researcher has stated, ' the legitimacy gap will fluctuate without any changes in action on the part of the corporation. Indeed, as expectations of the relevant publics change, the corporation must make changes or the legitimacy gap will grow as the level of conflict increases and the levels of positive and passive support decreases.'

The implications for a standard setter are then obvious. To the extent that the accounting standards mandating disclosures can be seen to be the instrument by which the larger society makes known its expectations, and which thus is the overriding part of the social contract, it then becomes necessary for the standard setter to evaluate whether it itself is responsive to the fluctuations of community expectations as regards disclosures.

Accounting Standards are not, of course, static. But many of the assumptions-especially those concerning disclosures- have changed little over the years. A measure of correspondence with changing social expectations would be to add some, and to discard some disclosures on a regular basis. Given the cycle of changes in the world today, that regularity should not be more than three years perhaps. But few standard setters are talking about it. Derivations of accounting standards are from philosophies and theories, rather than hard-core social realities. And therefore, when an Enron happens, those same people are more surprised than anyone else.

A process change is what is necessary, and perhaps the time is now.

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