Fairness, Justice, and Prosperity: A Challenge for Accountants and Teachers[1]

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I am delighted by the opportunity to speak to you at the Canadian Academic Accounting Association today. This is a unique lecture series on Foundations of Accounting Thought created by CAAA and four other international accounting associations in memory of Professor Yuji Ijiri, who was also my mentor. I follow in the footsteps of seven other internationally renowned scholars who have spoken in this series before me since 2018. I am grateful to the members, president, and officers of CAAA for this honor.

Abstract

In this lecture, I examine accounting as a human artifact developed to promote society's wealth and prosperity. Like other artifacts, accounting is a practice that combines skills and science to serve our ends. Like engineering, law, and medicine accounting needs both rules and norms, as neither alone is sufficient to serve its functions well.

There is no singular form of accounting, as its varied forms serve differing organizations and objectives. The forms of accounting can be classified into three broad categories: bookkeeping, managerial, and financial accounting. For organizations to sustain our prosperity, accounting must serve its five basic functions (see Section 6-7 below) in a fair and just manner. The responsibility for

ensuring that accounting serves these functions lies not only with the accounting profession but also with us: the teachers of accounting. Whether we merely train rule-followers or educate accountants capable of making difficult moral judgments to serve their public obligations will determine if our civilization survives the urgent pressures encountered in the age of AI.

I will begin by listing the sources of wealth in a society.

2. Four Sources of Societal Wealth and Prosperity

There are four sources of wealth of a society: exchange, production, discovery and invention, and loot.

In negotiated voluntary exchanges, societal wealth increases, since each side gains compared to their next best alternative (opportunity cost). The reason for this is simple. If Jack is willing to give a fish to Mike in exchange for an apple, both individuals must value the good received more than the good given up and is therefore wealthier after the exchange. It is hardly surprising that most centers of great civilizations were, and still are, located in coastal areas where trade is facilitated by cheaper maritime transportation. Trading families and cities have long been associated with wealth.

Production transforms or arranges one or more inputs to create new products of greater value, as seen in the agriculture, animal husbandry, mining, manufacturing, and service industries, where labor, materials, and capital are employed to create outputs of higher value, from the Chinese ceramics and Indian textiles of past eras to the automobiles and electricity of the present day.

The discovery of previously unknown sources of minerals such as coal, oil, and iron ore have also contributed much wealth to our society. The same is true of inventions that create new processes, such as the blast furnace that converts iron ore into iron, and inventions that devise artifacts to perform old functions better, or new functions, such as aircraft, computers, and solar panels.

Finally, some societies prospered through loot and plunder. However, even under the best of circumstances, it is a zero-sum game representing mere transfers. In most cases, overall wealth is lost during looting. It is an ancient practice, of which the colonial era conquests and plunder of Asia, Africa, and the Americas are more recent examples. Though plundering another society might seem to be a quicker option than creating wealth through exchange, production or invention, the former has proven not to be a steady-state route to prosperity. Exchange, production, and invention are far more sustainable, not to mention ethical.

Next, let us look at the role of artifacts in civilizations.

3. Artifacts and Civilization

Civilization consists of both ideas and artifacts, including the artifact of accounting, which is of special interest to us. Artifacts are objects and processes not found in nature, therefore artificial. When we discover and verify regularities in natural phenomena, we call these regularities laws. Collectively, the set of laws about a set of related phenomena constitute a science. Ohm's law in physics and Boyles' law in chemistry are familiar examples from high school.

In 2004 Nobel Laureate John Mokyr's classification, these laws constitute *propositional* knowledge, which help us answer "what" and "why" questions about nature. What happens to an electrical current if the voltage at the ends of a given wire increases by ten percent? Why does a rubber balloon expand when placed in the sunlight? Broad applicability of the laws of science has rendered this kind of knowledge a fundamental basis of our civilization.

In contrast, *prescriptive* knowledge helps us address the "*how"* questions and create artifacts. Boats and bridges are artifacts that help answer the question of how to cross a river, and clothing answers the question of how to survive in cold weather. Humans, as well as some other species including primates and birds, are exceptional at creating and using artifacts to help serve their needs.

An artifact has an internal environment consisting of its parts and their properties in relation to one another and to the composition of the whole. A weaver bird's nest is built from interwoven straws and hangs from a thin branch of a tree to provide shelter to the bird and its offspring. It also protects them from the weather and predators in the external environment. Both the external and internal environments of an artifact are subject to the relevant laws of nature (science). Whether, and how well an artifact serves the purpose of its maker depends on the fit between these two environments. As Herbert Simon pointed out in 1996, interface between the two environments is critical to an artifact serving its function for its creator.

Laws of science exist and govern the world, both natural and artifactual, independent of whether we humans know them or not.

When we discover a law through observation, inference, analysis, or instruction, and successfully verify it from observation, it becomes a part of our *propositional,* or scientific knowledge. In contrast, *prescriptive* knowledge does not exist independently of humans. It is developed through our experience: solving problems using guess work, trial-and-error, and using the known laws of science already discovered. This process allows us to build skills that, in turn, help us discover new laws of science.

So far, we have assumed that prosperity is a characteristic, or even the goal, of a civilization which develops scientific knowledge and skills to achieve that goal. We can now examine the nature and role of accounting through this framework.

4. Accounting as an Artifact

Accounting, too, is a human artifact. It is not found in nature and has been developed over the recent millennia as an essential feature of civilizations across various continents. In some cases, this development migrated across adjacent parts of the world, whereas in others, it developed independently in its varied forms. This behavior, as far as we know, is unique to humans. Although other species can solve problems through building shelters and storing food, to the best of our knowledge, they do not appear to have developed an accounting system for this behavior.

All sources of wealth mentioned above (exchange, production, and discovery[2]) need an appropriately designed form of accounting. Let

[2] Perhaps even loot and plunder at scale need accounting so the wealth can be shared among the looters without excessive conflict and violence.

us look at (1) some implications of its artifactual nature, and (2) its three canonical forms that develop as the scale of an organization's operations expands (Sunder 2004).

Since antiquity, accounting has been developed and practiced as a human artifact in many civilizations. It allows us to track and manage the quantifiable aspects of activities and events relevant to individuals, organizations, and society. Chapters 6, 7, and 8 in Book II of Kautilya's 3rd century BCE Sanskrit classic *Arthasastra*[3] are an elegant example of the accounting methods and control structures of treasury in the Mauryan Empire. They demonstrate that accounting and its associated administrative structures have been integral to human societal development for thousands of years.

Like other artifacts, accounting is the result of combining the skills of a craft with knowledge of relevant sciences, in this case mathematics, economics, sociology, and psychology. In this sense, it is analogous to engineering and medicine, as both fields serve our society through a combination of technical skills with known sciences, facilitating societal prosperity when deployed with appropriate values and good judgment.

At least since the mid-twentieth century, there have been attempts to explore accounting as a science. After the stock market crash and subsequent economic depression of the 1930s, the U.S. government enacted federal laws to regulate financial reporting and securities trading for larger companies. At the outset, this consisted of a handful of common-sense requirements captured in a few

[3] Shamasastry's (1915) first English translation is accessible online: (http://www.columbia.edu/itc/mealac/pritchett/00litlinks/kautilya/index.html) . Three volumes of Kangle (1960-1965) are an authoritative translation and commentary.

paragraphs that were largely accepted by the public, as part of the effort for economic recovery.

However, when these rules began to impinge on various interests, as rules always do, they met with resistance to their adoption. In response, some scholars tried to find a way to derive accounting rules from basic axioms, as done in mathematics (Sprouse and Moonitz 1962, Ijiri 1965). These attempts to find an axiomatic basis for accounting methods and practices, isolating them from self-interests of participants, received much attention but ultimately failed. They were rooted in a fundamental misunderstanding of accounting. Although accounting utilizes the laws of relevant sciences to support the craft, it is not a science. Ultimately, the axiomatic approach was abandoned.

Perhaps due to this conceptual misunderstanding of accounting and the subsequent abandonment of axiomatic derivation of accounting principles, academia has not yet fully embraced the artifactual nature of accounting akin to medicine and engineering. This resistance, and persistence of a degree of "science envy" shows up in two forms: (1) the continued search for mathematical consistency between reasonable stylized assumptions about human behavior and accounting practices, and (2) the idea of perfectly efficient markets rooted in no-arbitrage theory from economics as a guide toward gold-standard in accounting practices and regulation.

It does not help to judge artifacts by their consistency with the laws of relevant sciences; they must. Rather, artifacts are valued for how well they serve the purpose they are created for. Let us examine two

partially conflicting but ultimately complementary perspectives on accounting: rules and norms.

5. Rules and Norms

Human nature and behavior remain largely unchanged over time and geography. The characters found in classical literature from various ancient civilizations, such as the Mesopotamian *Gilgamesh,* Greek *Iliad,* and Indian *Mahābhārata*, do not differ in their underlying nature. The varied past experiences of individuals shape their beliefs and expectations, and they choose different actions under their specific contexts.

In social contexts, two mutually complementary and partially overlapping regimes help shape human behavior. One is the set of rules, regulations, and laws. These are formally specified and usually set in writing. For example, the rules for using a public swimming pool, regulations for selling pharmaceuticals to the public, and laws for selling financial securities to investors are promulgated and accessible to all. We develop an understanding of this formal regime through written or oral communication, or through our experience with the consequences of violations. Ignorance of this regime is not accepted as a valid defense for violations.

The second regime consists of the social norms within our communities. These are not explicitly specified in writing. Individuals learn social norms through a gradual process of acculturation over time, starting in early childhood through one's experience with their family, continuing in schools, work, and

engagements with the broader society. Learning the reactions to our own behaviors and observing third party social interactions play an important roles in learning the social norms of society. Rules and laws tend to be more general; in contrast, the specificity of uncountable contexts and examples is important to judge the applicable social norms.

Each regime has its advantages and limitations, and therefore neither works well when deployed alone. It is most beneficial both to individuals and their communities for both rules and social norms to be utilized in parallel.

Rules and laws are necessarily finite in their detail and therefore can enumerate only a limited set of contingencies in which each is applicable. We live in a world of uncountable known and unknown contingencies. Even the set of known contingencies can be too numerous to write down or contemplate. Unknown contingencies, such as Nissim Taleb's (2007) *black swan* events that no one has yet foreseen or imagined lie beyond the scope of written rules. This unavoidable incompleteness of rules leaves us with no guidance or basis for social coordination or conflict resolution when uncovered contingencies arise. With their open-ended nature and basis of acceptable human judgment, social norms can help fill this gap. For example, posted speed limits on highways are only a legal maximum, because the actual speed limit depends on what is safe under the prevailing weather and traffic conditions. The allowable speed limit is thus left to the reasonable judgment of drivers and law enforcement.

In financial accounting, revenue is recognized when it has been earned, not when cash and goods change hands. The timing of cash transfer is precisely identifiable, yet we prefer to use the subjective judgment of when revenue is "earned" to recognize it. Many attempts by accounting standard setters to write rules for revenue recognition in specific business contexts have not yet succeeded in eliminating the need for judgment. New contexts continue to arise through intentional creation or otherwise, bringing with them transactions and instruments with novel characteristics not covered by existing rules.

The inherent incompleteness of rules arising from their ex-ante specificity is sought to be made up by resorting to ex-post judgment using social norms. Judgments, when exercised with caution and responsibility, can deal with both foreseen and unforeseen contingencies not covered by rules and laws through considerations of fairness, ethics, justice, and morality shared by the community. It has been argued that such judgments should even override the rules and laws when application of the latter in a specific case yields an unfair or unjust outcome.[4]

Statutory and common law regimes in the Anglo-American-Canadian (excluding Quebec) legal system have some parallels with

[4] Arguments for fairness, ethics, and justice in accounting have a long history, including (but not limited to) J. R. Scott (1941), Yuji Ijiri (1983), Paul Williams (1987), Ahmed Belkoui (1996), Carl Devine (2004), Stephen Zeff (2007), Sunder (2010) and Kim et al. (2024). The then managing director of Arthur Andersen & Co. Leonard Spacek (1958) proposed a separate federal court to rule on accounting conflicts on basis of fairness and justice and build a body of case law to serve as a guide for the future.

the regimes of rules and norms. Statutes and regulations are written down and promulgated on known dates through the appropriate legislative, regulatory, or administrative processes and actions. By contrast, common law develops though a gradual process of human judgments about what is considered just and fair in specific cases, considering the prevailing social norms and mores. Even in criminal law, where statutes may specify conditions for a crime, the jury makes a judgment if the accused is *guilty beyond a reasonable doubt*. What is reasonable doubt is a matter of social norm; it is difficult to specify this threshold in a written form.[5]

What is true of law is also true of other aspects of civilized society on a smaller scale. For example, it is difficult, if not impossible, to maintain an orderly family dining table by rules alone. Often enough, an exasperated parent is driven to judgment and asserts authority: *No, you cannot check your Facebook account now because I say so*. Hosts of dinner parties seldom limit the number of drinks guests can have; most guests understand the social norm and act accordingly.

Not surprisingly, accounting too had come to rely on a judicious combination of rules and social norms that was reasonably effective for a long time. It is clear from the history of the development of written standards for financial reporting that the original "generally accepted accounting principles" (GAAP) was understood as a social norm of the financial community. Over the past century, however,

[5] When rule-makers have tried to specify numerical thresholds, e.g., 3 percent ownership of special purpose entities for consolidation in financial statements, the results have not always been good. Enron created more than 3,000 such entities, each owned below the threshold to hide billions of dollars of debt from its balance sheet. Also see Dye et al. (2015) for an analysis of consequences of creating thresholds in accounting rules.

the meaning of GAAP has gradually morphed into written rules formally promulgated and enforced by an authoritative body.

This transformation has consequences to which I shall return after discussing the different forms of organizations and the accounting developed to serve them.

6. Accounting in Organizations

In the mid-twentieth century, Barnard (1938), Simon (1947, 1952), and Cyert and March (1963) developed an economic theory of organizations. They viewed organizations as a set of people in relation to one another linked by a set of promises, contracts, understandings, and expectations. In Sunder (1997) I developed this idea into a contract theory of accounting. Accounting is the operating mechanism for implementing relationships among stakeholders in an organization.

Three canonical forms of accounting serve three corresponding forms of organizations (Sunder 2004). When operations grow beyond the memory capacity of the owner/manager, accounting is needed to keep track of (1) resource inflows and (2) resource outflows. This classical accounting form of *bookkeeping* serves to implement the proprietor/manager's relationships with customers, suppliers, etc.

When an organization is larger where proprietor delegates managerial functions to hired help, its accounting takes a stewardship form. Such organizations use a more complex

managerial form of accounting. In addition to classical bookkeeping, managerial accounting includes elements such as cost allocation, transfer pricing, and performance evaluation to serve two additional functions: (3) generate incentives and determine contract fulfillment by the participants, and (4) maintain liquidity its its factor markets by informing potential customers, suppliers, and employees about the costs and benefits of participating in the organization.

Public companies arise when their capital needs expand beyond the capacity of individuals, necessitating the inclusion of remote shareholders. *Financial* accounting arises to serve the needs of capital, labor, and product/factor markets. This advanced form of accounting includes both managerial and bookkeeping forms. A fifth function, common knowledge for contract renegotiation, is added to the four functions of accounting already mentioned. For this purpose, public disclosure of audited financial reports is added to the system. Henceforth, I focus my remarks on this fully developed form: financial accounting.

7. Accounting as an Operating System of Organizations

The five accounting functions discussed above (measurement of inflows and outflows, fulfilment of contracts, information for attracting new participants, and common knowledge for contract renegotiations for renewals) are essential to organizations. As the business environment changes, the set of contracts is modified to keep it viable. A viable set of contracts must fulfill two conditions: (1) it is expected to generate a positive surplus, meaning that the

resources generated for distribution to the participants exceeds the sum of the opportunity cost of the participants' contributions, and (2) every participant reasonably expects to get a positive share of the surplus generated, as promised.

In other words, by participating in the organization, everyone expects to economically profit by receiving more than his or her opportunity cost of contribution. If the organization's accounting system cannot perform these functions, dissatisfied but necessary participants quit, and unless replaced shortly thereafter, the organization crumbles. Efficient functioning of accounting and continual rebalancing of an organization's contracts and participants' expectations is a prerequisite for its survival. This is why trust in a just and fair system of accounting is crucial for an organization's survival and success.

8. Justice, Fairness, and Trust

In this contract-set perspective of organizations, managers perform a dual role. In addition to being a class of the participants who contribute skills in exchange for compensation, managers also represent the organization and deal with all other classes of participants on its behalf. This second role gives managers a pivotal position and privileged and asymmetric access to a great deal of information about the organization and its participants that others do not have. Managers also control the accounting system. This information asymmetry is difficult to sustain without fairness, justice, and trust. Let us elaborate on the reasons why.

First, contracts are mutual expectations, and uncertainty in the environemnt may not permit even the best managers to always fulfill them all. However, good managers can try honestly to make other participants believe in their good faith and plans to fulfill participant expectations. This does not mean that managers should share only positive aspects of the process; it can help build good faith among participants if managers also share the contingencies that may arise along the way with potential to disrupt organization's plans.

However, when adverse contingencies arise, at least some participants may lose money, jobs, or are otherwise disappointed. Under these circumstances, we know of no laws or rules that can keep participants from losing trust in their managers, and suspecting lying, cheating, or fraud in setting up expectations ex ante, or in execution and reporting ex post. Once this trust is lost, negotiating positions harden, and breakdowns, lawsuits, strikes, arson, and violence lawsuits may follow, making it difficult to preserve the organization. Justice and fairness, as seen by participants and society, are necessary for organization's survival and resilience under adverse conditions. Trust is not merely icing on the cake; it is an essential ingredient.

Second, this information asymmetry pervades the work of accountants and auditors. Individuals in those roles are granted special access to information through these privileged positions, and others depend on them for just and fair use of this privilege. This is the original and enduring meaning of professional conduct for doctors, lawyers, as well as accountants. It does not matter if a regulator or government agency redefines professional conduct by rules or statutes. We have known since the time of Hippocrates in

ancient Greece that no written rules can ensure professionalism in the absence of personal commitment to justice and fairness.

Third, societal perception of justice and fairness depends on the context. Even for serious crimes, the final verdict about the culpability of an accused is decided, under the common law, by the judgment of a jury of peers. Once evidence presented by the prosecution and defense is on the table, jurors who are not formally trained as lawyers must decide if the accused is *guilty beyond a reasonable doubt*. There is no formula or numerical threshold for reasonableness. We choose to leave the level of reasonable doubt to a jury's own social norms without defining it in statutes, believing that this is a better route to preserve trust in the fairness of the system. Surgeon is found guilty of killing a patient if, by the judgment of other experts, the surgery performed was in the best interest of the patient, even if the outcome was adverse.

What about accounting?

9. Century-Long March of Written Rules of Accounting/Auditing

Making informed and deliberate judgments when acting is the distinguishing hallmark of learned professions. Physicians choose between specific treatments or keeping a patient under observation depending on whether the pros of the treatment dominate the cons under uncertainty. Lawyers choose how to best represent their client, given the case-by-case circumstances. Society rewards these individuals for making such difficult decisions and for taking responsibility for them by granting these professionals high social status, significant independence to run their professional affairs, as

well as with compassion when the outcomes of a choice do not unfold as hoped for.

Accountants also used have this special status. Indeed, since ancient times, they may have been the first professionals who were granted this high social standing, such as the scribes of ancient Egyptian and Mayan societies. Arguably, the first ordinary person (not a ruler) whose actual name we know was likely an accountant in ancient Iraq: *Kushim*.

Yet in the past century, accountants have marched steadily toward giving up this special privilege in favor of writing increasingly detailed rules to guide their choices. Since search engines are free, they have lost their higher status and earnings (see Puri, et al. 2026). I do not have space here today to go into the reasons why and how this transformation has occurred (see Sunder 2003). In the meantime, the idea of "generally accepted accounting principles" (GAAP) has been transformed from a social norm into promulgations by authority with the power to punish violations.

10. The Way Ahead?

Despite the hazards ahead, it may be easier to simply stay on the current path. However, let me suggest some alternatives to reflect on and debate within the accounting profession and in academia.

First, the practice of accounting should consider returning to its roots in informed professional judgment to pursue just, fair and ethical financial reporting. This will help retain and build the public's trust in accounting and the profession. It will promote prosperity by

reducing the large transactional costs of dealing with public mistrust.

Second, reinstating professional judgment to its rightful centrality in accounting will require giving up the crutch of ever-growing volumes of written rules (under the guise of "standards"). Detail in standards, when carried beyond certain difficult-to-specify limite, tend to atrophy the profession's judgmental "muscles," making it difficult for accountants to walk on their own. After enthusiastically supporting the standardization project and creating structures like FASB, IASB, and PCAOB to progressively reduce room for professional judgment over the past century, it would not be easy. Such institutions, once created, have their own momentum and keep writing new standards as evidence of their productivity. That having been said, no real profession seeks shelter of rule-making bodies and allows them to narrow the room for discretion to ever lower levels.

Third, the accounting profession has organized itself into a handful of giant partnerships operating on just about every continent to serve multinational clients. The internal structure of these large firms demands detailed rules of accounting and auditing so that individual members will not take advantage of remote partners they hardly know under the guise of professional judgment. The agency and control problems of such large accounting firms favor support for the vast international standardization project we have seen blooming in recent decades. Professional responsibility functions better in smaller groups, and other learned professions cannot and do not practice in such large firms.

Fourth, statutory mandates for the audit of public firms have created an automatic demand for audit services, independent of their value relative to the cost. This mandatory demand, when legislated in the 1930s, was supposed to serve public interest after the Great Depression. However, the development of new markets over the last century has rendered these mandates unnecessary.

Instead, if organizations were allowed to decide if they wish to pay to have their financial reports certified by independent auditors to be "true and fair," the market price of audit services relative to the benefits of the audit to shareholders would drive the certification decision. All organizations would report if their financial statements had been certified by auditors, and what they paid for the certification (see Ronen 2010 for a proposal).

Audit services under competitive conditions are available for a vast majority of goods and services in our economy, and there is no reason why the audit of financial reports cannot function in a similar regime (see Jamal and Sunder 2011 for evidence from a field study).

Fifth, and most important, consider our own responsibility in accounting academia. With the advancement of standardization and rapid codification, accounting classrooms, texts, curricula, and examinations have shifted away from developing students' professional judgment toward learning the rules promulgated by authority. Such an education not only drives many talented students away from accounting programs but also helps populate the audit industry with people who are unable or reluctant to exercise judgement (see Puri et al. 2026). Truth, justice, fairness, and trust do not appear often in the classroom. Perhaps it is conveniently easier

for us to teach the standards than to help the students develop their own reasoned judgment after weighing its consequences for various participants.

11. A Profession in Service to Society

Yuji Ijiri was a giant of accounting thought. His oeuvre is an exploration of the structure of accounting: how it serves people, organizations, and society. Accountants are meant to mediate financial relationships by making responsible moral judgments, not by taking shelter behind written rules and standards (Ijiri 1983). George O. May (1946), an original accounting thinker who led Price Waterhouse & Co. and served as the vice chair of the Committee on Accounting Procedure wrote "The rules of accounting, even more than those of law, are the product of experience rather than of logic."

It is time for all of us to rethink the roles of fairness, justice, and trust in accounting practices, and the critical role of instruction in preparing future accountants to serve in that capacity. This urgency is greater than ever with the rapid development of artificial intelligence and its expanding applications to accounting (see Bertomeu et al. 2026).

Doubts about fairness, justice, and trust in AI models and their agents, and the question of AI's potential takeover of a rules-dominated accounting practice and education pervade news, opinion, and faculty lunch conversations. If AI fails the fairness-justice-trust criteria, perhaps it can be repaired or abandoned. But if AI-driven accounting also fails the test, the damage from the

absence of judgment in the system will be compounded and would be more difficult to reverse.

My concerns and suggestions may seem impractical or radical. However, the arrival of AI calls for practical as well as aspirational thinking. We can no longer wait to reflect and debate on these broader foundational issues facing accounting practices and education. By regaining public trust in accounting, the profession can earn its keep by continuing to sustain our civilization's prosperity.

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