Fairness, Justice, and Prosperity: A Challenge for Accountants and Teachers

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Eighth Yuji Ijiri Lecture on Foundations of Accounting Thought

Canadian Academic Accounting Association Annual Meetings

Banff, Alberta, June 20, 2026

An Overview

- Introduction
- Four Sources of Societal Prosperity
- Artifacts and Civilization
- Accounting as an Artifact
- Rules and Norms
- Forms of Organizations and Accounting
- Accounting as an Operating System of Organizations
- Justice, Fairness, and Trust
- Century-Long March of Written Rules of Accounting/Auditing
- The Way Ahead?
- A Profession in Service to Society

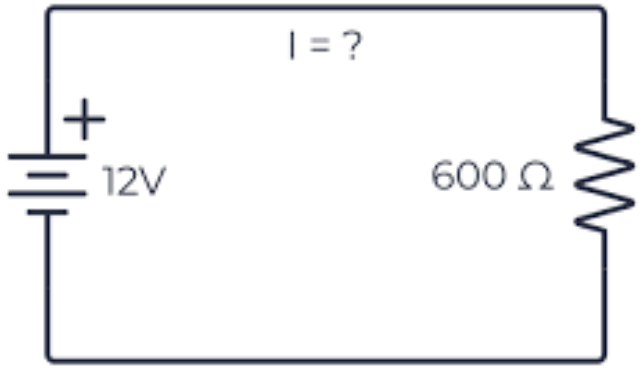
Four Sources of Wealth in a Society

- **Exchange or trade:**
  - Sharing the surplus (value to buyer – cost to seller), such as export of garments
- **Production or transformation:**
  - Creating surplus (value of output – costs of inputs), such as making garments
- **Discovery or invention:**
  - Mineral deposits, electric cars, medicine
- **Loot and plunder:**
  - Despotic and colonial rulers and invasions (Utsa Patnaik: $45 trillion India to UK)

Nature, Artifacts, and Civilization

- Propositional Knowledge: What and Why
  - Ohm's Law
  - Boyle's Law
- Prescriptive Knowledge: How
  - To cross a river
  - To survive in cold weather

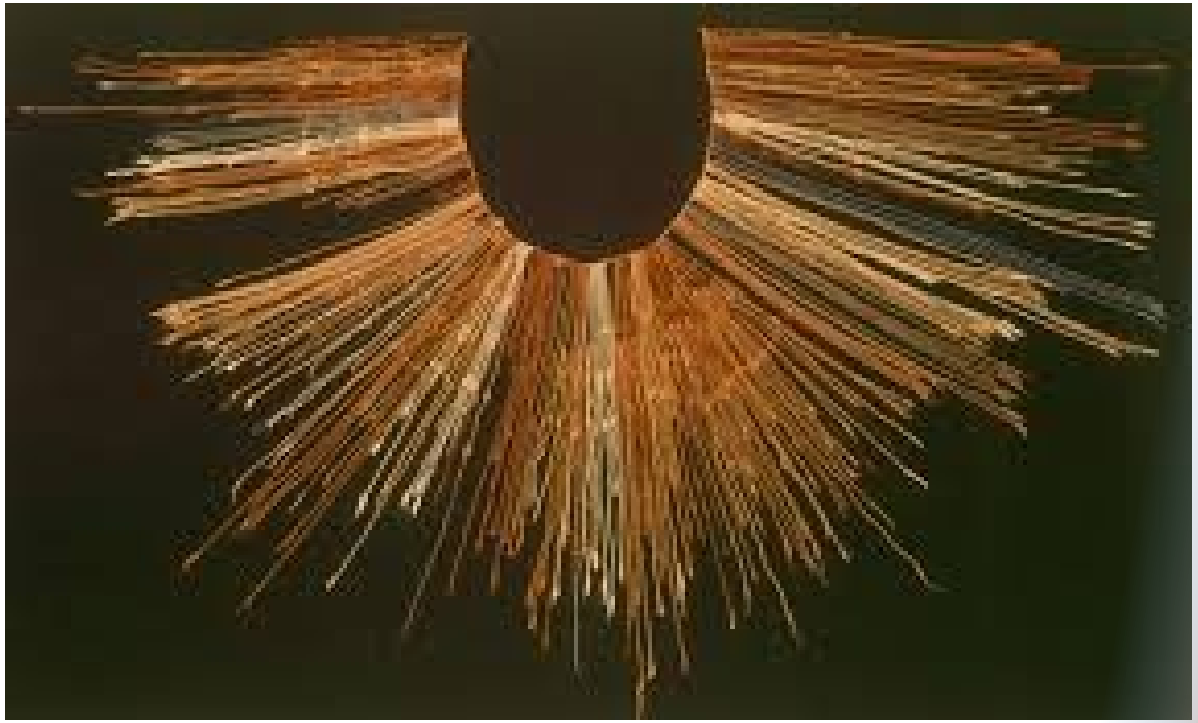






Accounting as an Artifact

- Accounting is a human artifact
- Appears in all civilizations
- Transmitted or independent development
- Artifacts are not unique to humans, but accounting appears to be
- Inka kippu



Accountants in History

- Egypt: Critical role in society (kingdom and temples)
- High social status of scribes (they were given tombs)
- In mostly non-literate societies, accountants knew how to count and write, and wielded enormous power and respect
- Profession as old as warriors



Two Guides for Behavior: Norms and Rules

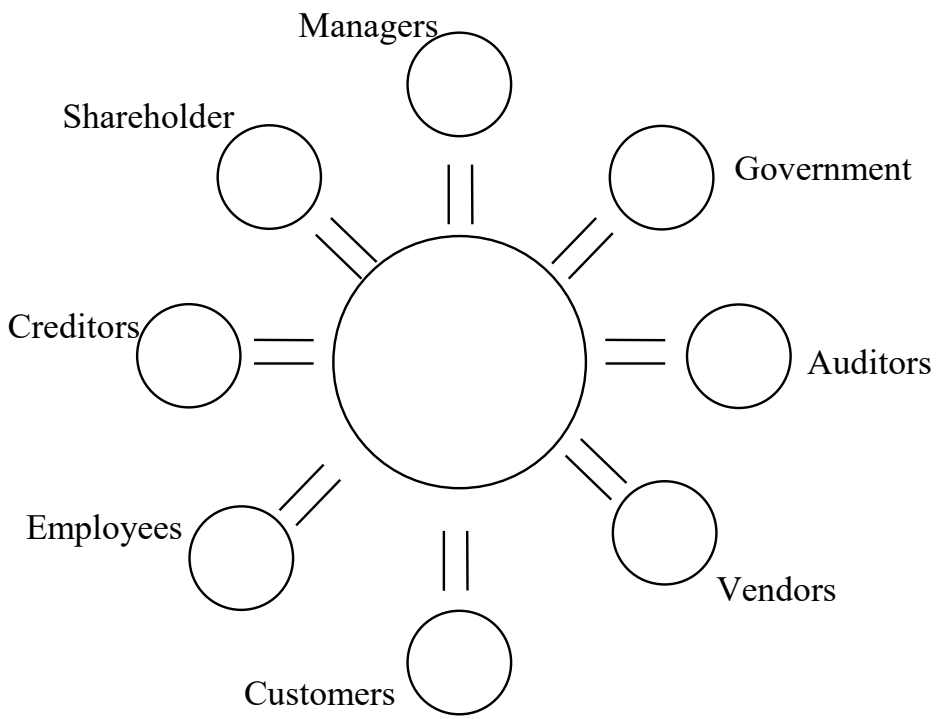
- Rules and norms of society
- They operate simultaneously; no precise division of their domains
- Classroom: rules (e.g., wearing a uniform) and norms (no conversation)
- Rules written down, changes are formally announced by authority; violations punished
- Norms not written down, changes imperceptible, informal and continual, no authority; violations sanctioned
- Compare: combination of statutory law and common/equity law in the legal profession

Social Norms

- Social norms: informal, unwritten mutual expectations that are specific to context and community
- What we do, what we believe others do, what we believe others approve of and expect of us
- Intersection of behavior, beliefs, and expectations
- Examples: language, manners, fairness, human relationships
- Not established as written rules and are enforced by a penal code
- Created by members of society by behavior and judgment
- Can be good and bad social norms, leading to reform movements

Organization as a Set of Contracts among People

- Labor: work in exchange for wages
- Vendors: goods and services in exchange for cash
- Customers: cash in exchange for goods and services
- Banks: loans in exchange for interest
- Managers: skills in exchange for compensation
- Government: public services in exchange for taxes
- Shareholders: equity capital in exchange for dividends, capital gains and residual rights



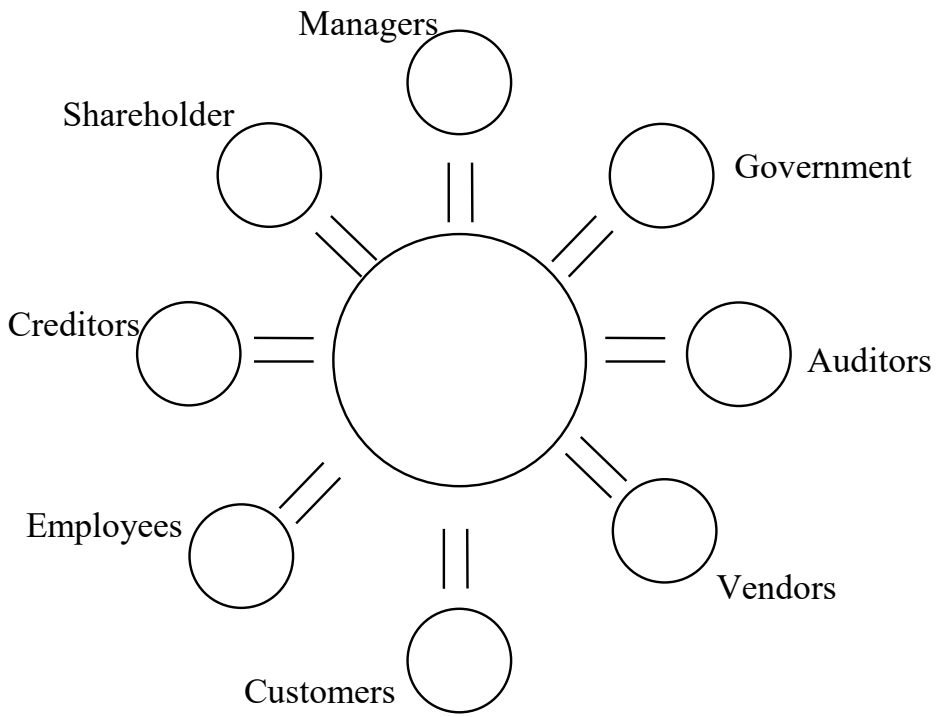
Three Canonical Forms of Organizations and Accounting that Serves Them

- Owner/manager
- Owner with hired managers
- Publicly traded firm

- Bookkeeping
- Stewardship/Managerial Accounting
- Financial Accounting

Accounting as an Operating System of Organizations

- Measuring resource inflows & outflows
- Contract fulfillment
- Attracting participants from factor markets through information
- Common knowledge information for contract renewals



What Is Trust?



- Defining trust in philosophy, psychology, and sociology
- Approximate understanding: Person A trusts Person B if A can rely on B to use discretion so their mutual goodwill is reinforced
- Reinforcement renders B **trustworthy** in eyes of A, and A develops **trust** in B
- Trust can be one-sided, contextual, and probabilistic; includes emotions, confidence and sense of security; “gut feeling” not quantified
- Liking overlaps with trust; disliking with mistrust

Privileged Access to Information from Dual Role of Manager

- Manager is a participant that looks after their own self-interest as well as acts on behalf of the organization in dealing with other interests
- When expectations are not fulfilled, disappointed agents doubt manager's good faith
- Professionals' privileged access to information and Hippocratic Oath
- Guilt decided by juries under common law

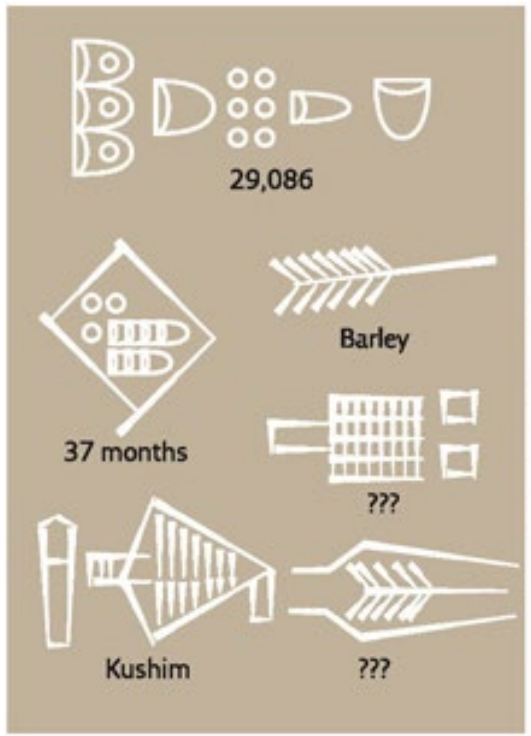
Two Special Professions: Accountants and Teachers

- A professional is defined as *a person who does well by being good*
- A professional is trained to see and choose what is good for society even when his/her personal self-interest is in conflict with societal welfare
- This is the critical function of the accountant in society now and has been so for the past five millennia since ancient Egypt and Mesopotamia
- High status in society: tombs, statues, power





The First Person in History Whose Name We Know? Not a King or a Prophet! (29,086 measures of Barley)





Reducing Large Transactional Costs of Dealing with Mistrust in Society

- Critical role of trust in family and our personal relationships
- When members of a group trust one another and behave in ways to deserve that trust, the group attains solidarity and functions smoothly with less friction and greater efficiency
- Not confined to families and small groups
- Also applies to large groups, villages, towns, cities, societies, and countries
- Consequences of high and low levels of trust among members of a group

Trust and Consequences

- Transactions have less friction, i.e., trust reduces uncertainty and verification work if it is well-earned
- In economic terms: lower cost of transactions in trade and commerce
- Trust and trustworthiness of citizens, transactions, information, and institutions in a society is a primary determinant of its peaceful co-existence and prosperity
- When trust is weak or absent, transactions and interactions among people demand costly care, verification, and contingency plans
- For example, the ability of people to buy food without risk of adulteration, medicine without risk of contamination, and securities without risk of financial misrepresentation or fraud, significantly reduce the cost of transactions in society

Trust and Societal Wealth

- Increasing trust → reduces the cost of transactions, creates smoother trade
- Increase efficiency of production and discovery
- Rich economies generally characterized by more trust, lower transaction costs
- When trust is violated or broken (e.g., Enron disaster), legal, political, and economic systems take punitive and corrective actions
- Absence of predictable corrective action → vicious cycle of ever-increasing violations, conflicts, chaos, and economic decline

Trust in Trade and Finance



- Trust is a relationship attribute
- It cannot be assigned as the responsibility of a subset of people or specified section of society
- Trust enables diamond merchants in Surat, Antwerp, and New York to exchange bags of gems without spending the time and money on costly examination of each precious stone
- Financial systems are based largely in virtual (not physical) objects
- Trust is critical to efficient functioning of accounting and finance
- Every citizen contributes to trust (or its absence) in society
- Two special classes with a very special role and responsibility for building and maintaining trust

Teachers of Accounting

- Teachers (along with parents): unique responsibility to instill habits of trustworthiness and integrity
- Understand the history, variations, and causes of prosperity in society
- Consequences of pursuing narrow self-interest for the welfare of all
- Understanding the value and importance of **public versus private goods**
- Of all teachers, accounting teachers have a special responsibility
- Students of accounting must learn to look beyond the wishes of their paymasters
- Earn respect in society as a professional
- Importance of social norms, consequences of breaking them
- Trust is at the root of finance too

Accounting in Service to Society

- Accounting as a key to society's prosperity
- Ijiri: Accountant as a mediator among people; has privileged information
- This privilege must be exercised ethically with fairness, justice, and responsibility to promote trust
- To do so, accountant needs to use judgment to conform to rules as well as social norms
- Arrival of AI should not tilt accounting even further towards rules
- Professionally responsible accountants and their teachers may save the day

Thank You.

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