

Video Transcript

Pathways Vision Model: Part 3

Topics

- Part 3: Explains the Vision Model elements that connect and motivate decisions, which contributes to a prosperous society.

Transcript

Welcome to Part 3 of the 4-part series on the Vision Model. Here we explain the elements we didn't cover in Part 2: the consequences of users' decisions; critical thinking; and prosperous society.

This time, we begin with three questions we'd like you to contemplate during this video:

- How will accounting motivate you to work harder and smarter, and ensure you are rewarded for doing so?
- How can the Vision Model help you think more critically on the job, which will help you realize your full potential?
- How does accounting benefit society?

To answer these questions, you'll need to understand the highlighted Vision Model elements, starting with the consequences of users' decisions. This is our favorite element and why we're so enthusiastic about accounting. In fact, without it, the public perception that accounting is boring, well, it would be pretty close to reality.

Users' decisions can have consequences for both economic activity and accounting judgments. For the sales department example in Part 2, the corporate executives' bonus decisions have direct consequences for you and others in sales. If the department meets the quarterly sales target, well, you get bonus, otherwise you don't. That's a pretty direct consequence. Importantly, anticipating a bonus creates incentives that have additional indirect consequences. So, we're going to be focusing on anticipated consequences.

These incentives can be positive or negative. Here are two examples of positive incentives:

First, anticipating meeting the target and getting a bonus gives you a very positive incentive to work more efficiently and effectively towards the company's goal to increase revenues. When multiplied across the entire economy, similar incentives can lead to the efficient allocation of capital, job creation, and tremendous wealth generation.



Second, if you've met the target at the end of the quarter, well, you have a positive incentive to make accounting judgments that faithfully reflect your performance.

Keep in mind that the corporate executives' intent was to create these positive incentives when it designed the bonus plan. But the fact that the plan exists doesn't mean you and others in sales will act on these positive incentives and thus that the executives will realize the intended benefits of the plan.

For positive incentives like these to be effective, the parties who are to act on them, and that includes you in the sales example, well, you must understand the related accounting. For example, your bonus incentive might not be effective unless you know delivery is required for revenue to be recognized.

Why? Because you might not put forth the extra effort to ensure delivery occurs before the end of the quarter, which could mean you fall short of your bonus.

So, one reason bonus plans and other compensation schemes can fail to realize their potential is parties don't respond effectively to positive incentives. Another reason is unintended consequences that occur when parties act on negative incentives.

Here are examples of two negative incentives that often occur at or near the end of reporting periods:

First, if you did not meet the target at the end of the quarter, you have an incentive to commit fraud by exaggerating revenues. That's a pretty negative accounting judgment. Abusive revenue recognition is at the top of the list of fraudulent accounting judgments.

Second, if you haven't met the target near the end of the quarter, but not quite at the end of the quarter, you have an incentive to discount prices excessively to accelerate sales into the current quarter that might otherwise been made at the higher price in the next quarter. That's a negative effect on economic activity. Matter of fact, it's called "manipulating real activity" to serve your self-interest that are at odds with the company's interest. As we shall see later, accountants do several things to try to ensure individuals don't act on these negative incentives.

Next, let's briefly revisit one of the questions we posed earlier. How will accounting likely motivate you to work harder and smarter? Our answer has two parts:

First, regardless of your job, you or your superiors will likely be rewarded for meeting targets that are based on accounting measures.

Second, to act effectively on the related incentives, you'll need to understand the related accounting. You won't need to be an accounting expert, but you will need to know how to work effectively with accountants.

Next, we'll wrap up our discussion of the consequences element by explaining the essential role it plays in connecting the model's elements.

The arrows connecting the elements illustrate the elements' interdependencies and, in particular, how they affect and are affected by each other. There is a circular flow of cause

and effect, starting with economic activity affecting accounting judgments, which affect the usefulness of information, which affect users' decisions, which have consequences back on economic activity. But, this interdependence means all of the arrows can be reversed and everything affects everything.

The incentives described earlier depend on this interdependence, as do the points we will soon raise about critical thinking and a prosperous society. And this interdependence wouldn't exist without the model's consequences element. So, now you know why it's our favorite!

Next, we'll answer another question we posed earlier. How can the Vision Model help you think more critically and thus achieve your full potential on the job? By now, we hope you realize that no matter what path you pursue, you're going to find yourself in at least one of the model's elements during your career.

And, regardless of where you are in the model, you will be rewarded for thinking critically. This means, among other things, you'll need to know how to:

- Solve complex problems.
- Develop creative solutions.
- Identify important problems.
- And be skeptical, but not cynical.

Now you might be thinking this means you need to develop considerable expertise directly related to your job. For example, know how to price products if you go into marketing or create financial reports if you go into accounting. This is all very true, but this won't be enough for you to achieve your full potential during your career.

Because of the model's interdependencies, you'll need to know how to think critically about all of the model's elements. For example, leading accountants can think critically about the economic activity behind the numbers they report and the implications of these numbers for investors' and other users' decisions.

Similarly, successful marketing managers can think critically about how faithfully accounting numbers capture their performance, and the consequences for them of decisions based on these numbers by their superiors, including the extent to which they are compensated and can secure resources to pursue new initiatives.

Next, we address the third question we posed at the start of the video. How does accounting benefit society? We've hinted at the answer earlier, but let's take a closer look.

The ultimate outcome of the model, right at the top, is a prosperous society. There is no consensus regarding what constitutes a prosperous society, and the model isn't based on a particular definition.

Rather, accounting is necessary for a prosperous society, however defined, and user decisions are good to the extent they increase this prosperity, which depends on the usefulness of accounting information. That's the connection.

For this course, we're going to focus on ways accounting contributes to a prosperous capitalist society, where the pursuit of self-interest associated with capitalism is balanced with the pursuit of the public's interest, and where this balance depends on the political, social, economic, legal, and cultural environment.

Within this context, accountants who are licensed by their government, including Certified Public Accountants, that is CPAs, well, they have a responsibility, above all else, to serve the public interest in ways that help facilitate a prosperous society. They do so by striving to enhance all elements of the Vision Model and thus promote economic activity that leads to a more prosperous society.

In this regard, accountants do three things that benefit society:

First, accountants create measures that are used in performance metrics as incentives, which are essential for capitalism: Incentives are the "engine" of capitalism and accounting measures are the "fuel" for this engine.

However, unbridled incentives, well, that can result in greed, which leads to the second way accountants benefit society: To curb socially undesirable behavior, accountants create, monitor, and enforce controls; audit financial statements; and otherwise ensure companies comply with laws, regulations and standards.

The third way accountants benefit society, is they provide decision support that spans all the elements of the Vision Model.

So, not only do accountants provide the "fuel" for capitalism, they also provide the "brakes" and the "steering wheel".

Thus, accounting facilitates a healthy tension between the competitive forces associated with capitalism and the cooperative forces associated with society, while providing decision support so that everyone can make more informed decisions. The result is a more prosperous society.

Hope you enjoyed this video. See you in Part 4, where we'll explain how the Vision Model will guide us on our enlightening journey into the language of business.