

THE EXPANDING BORDERS OF ACCOUNTING – ARE WE TRYING TO MEASURE THE IMMEASURABLE?

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Introduction

"In the present lies the past and in our time lie they roots for the future." This well-known Dutch saying is extremely applicable to the subject of the expanding borders of accounting and, in connection therewith, the role of the accountant.

It is a theme that has been reflected more and more clearly in a number of topics dealt with by three successive Jerusalem Conferences on accountancy.

The first conference in 1971 addressed itself to "the educational and training requirements of the accountant of to-morrow". One of the conclusions of the first speaker, Dr. J. M. S. Risk, was: "Accountancy is part of the general science of measurement and control, fundamental to the effective use of the world's resources. Accountancy has a major contribution to make to the well-being of humanity. Whether engaged in the practice of public accountancy or in some other field, the accountant of to-day and of to-morrow has great opportunities within his reach." In other words, great opportunities for measurement and control of the use of the world's resources.

A topic in the second Jerusalem Conference 1974 on accountancy was "Auditor's report-Society's expectations versus realities." I quote Dr. M. Knoll: "Social audit is a novel topic and covers the responsibility of companies to the community, employees, consumers and the general public . . . We seem to think that it is too early at this stage to extend the attest function to this area", and Mr. E. A. Weinstein: "The idea of social auditing is completely new. It is a dream at the moment, without enough current methodology and beyond judgmental capacity as it now exists." We see developing a new concept - "social audit" - and a certain description of it but we note also apprehension for the future and an attitude of reserve in relation to the primary functions of the accountant.

And to-day, at the third Jerusalem Conference, the theme is "future shock", and one of the three topics is fully dedicated to the measurement of the immeasurable.

Thus the three successive conferences are connected with invisible threads. This is not a mere matter of chance it is unavoidable: the development of our thinking on the subject cannot be dissociated from the ideas of the recent past, and future conclusions will be drawn from the considerations of to-day. With this notion in mind, I will now follow the invitation of the Congress Committee and try to give a critical survey of present trends in my country as they manifest themselves in theory and in practice.

Some historic remarks

Prior to the 1970s information about companies in Holland was restricted to the facts and figures in the annual accounts and the explanation in the director's report. Discussions about the contents of annual accounts came to a preliminary conclusion in 1970 when, after long debates, the Act on the Annual Accounts of Companies was passed. Whereas before the Act, full emphasis has been given to financial data in the annual accounts while other information in the annual report had been "in small print", the adoption of the new law opened up a range of new possibilities for concentrating on other problems.

Of course there followed a period of discussion and further elaboration of the law. Special reference should be made to the tripartite consultations among business, trade unions and accountants and their considerations and recommendations concerning the annual accounts.

These recommendations carry great authority thanks to their broad social and economic base.

In addition, I believe that the social troubles of the late sixties exercised a favourable influence in broadening the interest in more information on the companies. Many traditions were broken down, and, in that climate, it was quite natural that questions on more information were posed. In the ensuing discussions accountants played an important role, and thus it is only logical that business organisations and trade unions participate in the debates backed by the technical advice of accountants. Accountants are the experts in reporting about enterprises.

The subjects discussed at the so-called "Accountants' Day", organized annually by the Netherlands Institute of Registeraccountants (NIVRA), have special significance. On these days the profession opens itself to the public in their considerations of a subject of public interest.

Debaters and commentators are frequently well-known government officials, businessmen, trade union leaders, financial and social experts and so on. Subjects in recent years have included "society and companies", "storms about norms" (that is to say the norms used in the preparation of annual accounts), "corporate forecasting" and "corporate behaviour and information of society."

In addition, the professional organisation has study-committees at work continuously. In 1971 one committee reported on "The Accountant to-morrow?" and came up with several far-reaching ideas for the field of reporting by companies. Since 1973 another committee has been studying the scope of the audit report. It published a draft report in 1976. Many comments from accountants and accountants' firms are incorporated, and within a few months we can expect a definite publication.

Important chapters in this report consider the information-requirements on companies of no less than 48 groups of persons and bodies including private persons, students, shareholders, creditors, government and so on.

A third committee is studying the implications of interim-reports of companies. Recently a permanent committee has been established to perform a comprehensive analyses of the dynamic functions of the accountant.

Last but not least I mention a number of articles in the professional literature about all aspects of reporting on companies. Special attention was paid to the well-known "Corporate Report", a discussion paper published for comment by the Accounting Standards Steering Committee of Institutes of Accountants in the United Kingdom (1975).

This summary reflects the accountants' interest in and endeavours toward elucidating the problems of reporting on behalf of companies in a much-demanding society.

I will now try to summarize the present trends in my country in this endeavour.

Current trends in reporting by companies in Holland

It would take too long to analyse in this survey the contents of all the reports mentioned and the technical literature to which reference has been made. An evaluation of the present position with regard to the development of ideas will hopefully be sufficient.

In addition, it should be said that I shall not here go into the information which belongs to the annual accounts themselves (balance sheet, profit-and-loss account and the explanatory notes). A great deal can be said about these, and accountants do not always think alike, particularly when it is a question of the evaluation of principles to be followed. To mention one example: the use of actual value in the annual accounts is still considered by some as "an attempt to measure the immeasurable"; on the other hand, there are many who are convinced that the actual values can be determined in a reasonably accurate way and that their use provides better information, it being better to be vaguely right than absolutely wrong.

We should also bear in mind - and this is a point about which I personally feel strongly - it is not the accountant who has the last word when a decision has to be made as to what is to be included in the annual accounts or, more generally, what information the company ought to furnish. Political, social and economic considerations and influences lead either to legal regulations with regard to the contents of the annual accounts and the annual report or to basic principles generally accepted by society which are then followed.

In principle the accountant should take a neutral stand in this respect. As an individual, he has right to his own preference either for more or less information in the annual accounts and the annual report, but as a professional person he is *neutral* and should wait and see what legal regulations are enacted or what basic principles are generally accepted by society. "Waiting" of this nature *in no way* means that the accountant takes a *passive* attitude. He still takes part in the comings and goings in the community and that obliges him to put his professional "know-how" at the disposal of all those - non-accountants - who call on or need his expertise. The accountant can actively contribute his knowledge and experience, asked or unasked, as soon as this contribution will clarify the problems or ensure a technically better solution.

In his function as neutral expert he must accept the fact that regulations may come into force which he personally finds difficult to swallow or which, in a professional/technical sense, he considers poor or incorrect.

What information is the company expected to give besides that which is included in the annual accounts themselves whatever that might be?

In my opinion there are five subjects to be considered here, namely:

- 1 interim reports
- 2 forecasts
- 3 accounting for employees
- 4 social accounting

Over and above these a great deal of importance is attached to an assessment of the qualities of the company in connection with its going-concern chances. Investigations into this can be instigated and, in this way, we come to

- 5 management audit or business diagnosis.

1. *Interim reports* are issued by many (large) companies. The contents, however, vary considerably. The simplest form of interim report is that in which it is stated (e.g. after almost six months) that, on the grounds of the results dealt with up to that point, a better/same/worse annual result is expected than in the previous year. The other extreme is an interim report consisting of a quarterly account containing a balance sheet, profit-and-loss account and explanatory notes. Between these two extremes all kinds of variations appear in practice. These variations nearly always fulfil at least the rather conservative requirements of the Board of the Stock Exchange which demands that interim information be given (in the ninth month of every financial year) on the state of affairs during the first half of the current financial year. More formal regulations than those of the Stock Exchange just mentioned do not exist in Holland, although there is certainly a great need for adequate, up-to-date information on events in a company during the course of a year. The financial press and the trade unions expressly ask for this, in particular as regards companies with poor returns. Concrete demands from the trade unions and other social groups have, however, not been put forward.

The Netherlands Institute of Registeraccountants has given a sub-committee the task of investigating what responsibility the accountant bears for interim information of whatsoever nature and the measures that enable him to fulfil this responsibility. Insofar as the interim report accounts for a period already elapsed (quarter or half year), there is no fundamental problem for the accountant. Accounts for periods of less than a year are, of course, as equally open to audits as annual accounts. Technical problems may arise if too little time is available or the interim reports are less accurate, but these can be solved.

If forecasts for the future are given in the interim report, then quite a different situation arises, a situation which is dealt with in the following point.

2. No requirements whatsoever is formally demanded with regard to *forecasts*, either by law or by the Board of the Stock Exchange. This Board does, however, demand publication of each fact or each event within the company which, it may be assumed, will exercise a considerable influence on the share price quotations. The question is, however, how far do forecasts come under this ruling, for forecasts, in any case, do not deal with actual facts and events.

The interest in forecasts is, naturally, great, certainly in a period of economic stagnation in which a fair number of companies are not having an easy time. In 1977 an "Accountants' Day" was devoted to that subject. In addition to interesting considerations on macro-economic forecasts, an explanation was given of the techniques by means of which prognoses in the company can be/are arrived at, and Prof. drs. G. G. M. Bak gave a preliminary recommendation on the possibilities and limitations of the accountant with regard to prognoses.

It can be said that no strong pressure is being exercised, for example, by trade unions and/or the financial press for the inclusion of detailed information with regard to the future in the annual report.

Trade unions have certainly said that it is important for employees to have a budget for the coming year at their disposal, preferably in the form and classification of a profit-and-loss account, but, all the same, there is an understanding of the problems incumbent in this. Nevertheless, it is argued, the standards for a paragraph on the future in the annual report must be further developed. And, with that, the question of whether it would be possible in practice to formulate these standards is left hanging in the air.

How should the accountant react to forecasts in the annual report? On this subject Prof. Bak suggested the following which was not contradicted:

"Just as the issue of an annual report or the annual accounts, the publication (or not) of prognoses belongs to the competence of the management. Whether it decides to do this or not is a question of policy within the framework of the legal regulations thereon. In relationships within the Netherlands it would appear that an obligation to issue information with regard to the future to the Works Council is nearer than an obligation to publish prognoses for the benefit of the capital market."

In the first instance, therefore, the accountant waits to see whether social developments lead to prognoses being made in the annual report regardless of whether they are obligatory or not. This is in line with the accountant's neutrality. But, in the meantime, he need not sit still. He can see, anyway, that sooner or later a continuing trend might lead to annual reports with prognoses becoming more the rule than the exception. The question then becomes: is the accountant able to give an opinion about prognoses?

Bak answers that "the function of the accountant cannot stretch further than the giving of an opinion about information, therefore on the *presentation* of the expectations". No opinion can be given on the expectations themselves; the accountant's opinion cannot refer to the future as such (for it might then be said that the immeasurable was being measured). With a variation on a statement attributed to Churchill one might say:

"It is always wise to look ahead but impossible to look further than you can see."

Has an accountant's opinion on the presentation of expectations any meaning? Bak considers that it has: "For users of prognostic information, a professional and independent opinion can be of importance with regard to the quality of the planning and decision-taking process in which the information plays a part. Besides this, there may be need of the accountant's opinion on concrete information: the prognosis which is generated in such processes. As regards the latter it is a ques-

tion more particularly as to whether a prognosis forms a consistent whole, a satisfactory reproduction of the expectations within the company and whether the entire information, including explanations, is sufficient for those who wish to make use of it." The accountant would then, in formulating his opinion, have to say "in how far:

- the prognosis is based on information about the future as this is made use of within the company;
- he considers the information given in the prognosis to be sufficient".

Bak is of the opinion that the accountant could come to such opinion-formulating provided he - with the help of a team of experts, if necessary - has acquired sufficient knowledge about the planning and prognosis techniques which are followed in the company.

Regarding Bak's position - although in itself consistent - the following fundamental notation was made during the "Accountant's Day".

It may well be true that the accountant is only able to give an opinion on the *presentation* of expectations, but the public which is advised of this opinion will not notice the fine nuance between that and an opinion on the expectations themselves, or will not consider it important. One might fear that interested parties in the society might think the accountant has said that the company will make so-and-so profit in the coming year. In other words, however carefully the accountant chooses his words, the readers will think, all the same, that he has measured the immeasurable. With that he raises more expectations than he can justify.

It is for this reason, in my opinion, that many accountants presently reject the idea of certifying a prognosis. It is, at least, considered premature. I am also of the opinion that, for the time being, there cannot be any question of it. Reconsideration, however, is possible when

- a. worked-out future-prospects paragraphs are indeed included in the annual reports and
- b. definite agreements have been made on the wording of an audit certificate to be added, and careful reports and explanations on the meaning of such a certificate have been given to the public and such bodies as are in the habit of studying annual reports.

In an advisory capacity the accountant is able to contribute his professional expertise in a development of this nature.

3. *Accounting for employees* is coming more and more to the fore in Holland. The number of firms which issue separate annual staff reports for and to the personnel, in addition to the customary annual report, is growing steadily.

Such a report deals mainly with the social policy of the company. All kinds of data about the numbers of the staff, staff changes, age structure, primary and secondary conditions of work, internal training and education, possibilities of promotion, absences due to illness, complaints, disputes, productivity and whatever more there may be, find a place in the report. The report gives a good measure of actual data which are/can be of interest to the staff and staff representatives, and these data can, in general, be checked. I do not know of a

personnel report accompanied by an accountant's statement, but, in principle, the accountant ought not to have any difficulty with this. He can measure what can be measured and, from the results of his investigation, make his report. His conclusion, of course, applies only insofar as the staff report contains a full report of factual data. As soon as statements over and above this are made or consideration is given to future work-opportunity aspects based on prognosis, it is quite a different matter, and what has been said in the previous paragraph will apply.

4. *Social accounting* is defined in the well-known British "Corporate Report" as "the reporting of those costs and benefits, which may or may not be quantifiable in money terms, arising from economic activities and substantially borne or received by the community at large or particular groups not holding a direct relationship with the reporting entity". Drs. I. Kleerekoper spoke about this on "Accountant's Day" 1976: "I find it risky and not without danger to arouse in those interested (and that circle is nowadays extremely large) the expectation that it will be possible to supply a usable account of social costs and benefits including therein elements which can or cannot be quantifiable in terms of money . . ."

We arrive here, in *optima forma*, at the real crux of the matter. Are managers of firms able to measure social costs and benefits? Sometimes yes and sometimes no. The social benefit from an investment can, for example, be measured by the number of jobs it creates. A monetary value can be assigned to a job (e.g., the average wage plus other labour costs). Thus it can be presumed that the social benefit from an investment is determined by the number of new jobs multiplied by the amount of the average labour costs. Opposed to this benefit there is also a social cost. For example, the investment means that an area of natural beauty is sacrificed and that unavoidable additional pollutants are emitted into the environment. In my opinion, these costs are not monetarily quantifiable which means that the account of social costs and benefits becomes a misnomer. I do, therefore, agree with Kleerekoper that it is dangerous to arouse the expectation that we need only continue to study and develop, and we shall, within the foreseeable future, be able to draw up a social account of costs and benefits for each company - whether accompanied by an audit certificate or not. Social costs and benefits are, by their very nature, measure units (environment, noise, etc.) which cannot be measured. I personally do not visualize for the future an account of social costs expressed in money, per company, in agreement with the definition of the Corporate Report. The boundaries of accountancy cannot be stretched so far.

This does not mean, however, that the last word has been said on this subject. It is certainly not unreasonable for companies to be asked to define in what way they, in the development of their firm, consider the social advantages and disadvantages of a given project. As Prof. dr. C. Brevoord put it on „Accountants' Day" 1978: "The time is past when the company only felt itself obliged to justify its responsibility and the giving of information to those who had a financial interest in the company; at present the circle of those (with a right to be) interested is much wider."

As soon as this is taken as a basic principle, reporting by the company takes on a different nature from what it has been in the past. The annual report has, for years, been issued mainly on behalf of the capital market. Such information, tuned to such a market, will, without doubt, remain essential given the existing economic order. But in addition, there are other interested parties who have need for information of a different sort, e.g., information about the opportunities for employment, activities to avoid environmental pollution, technological developments. Prof. Brevoord mentioned the following as interested parties:

- governmental bodies: state, province, tax authorities
- employees: trade unions, company's own personnel
- customers/firms in branch
- shareholders
- financial bodies
- creditors
- financial press
- education/research

If one wants to fulfil the need for information of these interested parties, the form of representation of the annual report will, in principle, have to be reviewed. It seems very probable that all needs can be met by means of additions to the present form. The questions which arise are: which interested parties are really interested?; in what are they interested?; what needs can (and will) be met?; can all the information required be contained in *one* report or would more than one report be more effective?; would it be of use to subject the measurable information to an accountant's check and to have an accountant's statement included in it?

Depending on the nature and extent of the company one may get very different answers to these questions. Following from the remarks made above, it does not seem possible for the accountant to take a particular stand on these questions. He is, after all, a neutral expert. It is for the government and the employer to determine policy in these matters. As an expert in the field of reporting the accountant can, of course, give advice and consult with those interested as to the how and what, and I am convinced that the accountant - preferably, as far as information and higher education is concerned, supported by his professional organization - can play an important part in such an advisory capacity. But the question of the desirability of an accountant's check is a matter to be determined *after* the basic policy is established.

5. With the *management audit* - in simplified form in Holland also sometimes called a business diagnosis - we leave the field of reporting as done by the company. Within the framework of the subject "trying to measure the immeasurable" I should like to make one remark, however. There is a demand for an independent and professional opinion on the "health" of companies, and this demand is increasingly being met. "Health" is defined in terms of, e.g., profit-making ability/resistance/vulnerability in the market, chances for continuity, qualities of the management, labour supply, efficiency, internal and administrative organization and so on.

Questions on these features may be asked by government, directors, bankers,

future shareholders, trade unions, work councils and they may be put to the accountant. Is he able, after sufficient investigation, to give the answers?

Our answer is that it depends on whether the information requested relates to measurable quantities. A general "health certificate" with regard to a company can probably never be given by an accountant, for any company is surrounded by uncertainties. Set-backs, for example, sometimes come entirely out of the blue. And, as regards the individual categories, hard and fast assessments are not always possible, e.g., as to the strength of management. On such questions, there will be differences of opinion - and on perfectly good grounds; they cannot be quantified conclusively; the most one could hope for would be the establishment of comparable units.

What the accountant, in my opinion and from my experience, *is* able to do - provided adequate professional expertise has been brought in, e.g. from management consultants, technologists, psychologists - is to give some opinion on the strong and weak points of a company in relation to foreseeable developments on the markets in which it operates (raw materials market, sales market, capital market, personnel market, etc.).

The accountant who makes out a management audit does not, therefore, in my opinion, reach one final conclusion. He is able - again provided that there is sufficient professional support - to pinpoint the strong and weak points in the company. He is not measuring the immeasurable.

Those who examine the results of a management audit can and must, in the end, draw their own conclusions, from the description received, in the matter of participating or not, initiating a take-over, granting subsidies, increasing credit, strengthening management . . . The decisions are made by them, not by the accountant. In this way each keeps to the responsibility fitting his own function.

The future

When the Congress committee asks how we envisage future developments and what we see as the utopian system of internal reporting in companies, I should like to reply by again quoting Churchill "It is wise to look ahead, but impossible to look further than you can see". I should be glad to make my ideas known, insofar as they can be formulated, and in the hope that they will, at the same time, serve as a resumé of what has gone before.

1. In the game of social forces, the accountant should refrain from campaigning for his utopian ideals. As a private person he has full rights to voice his opinions, but as a professional he must assume a neutral position, the position of one who makes his expertise, whether asked for or not, available to society where necessary.

2. I see developments in the field of accounting progressing gradually from the present state of affairs. I am of the opinion that progress, based on current trends, can be foreseen in the following sectors:

(a) With the acceleration in economic life and the more and more insistent demand for information, a considerable extension in the number and contents of interim reports accompanied by an accountant's statement is fitting.

(b) There is a clear need in the annual reports for a prospective paragraph; however, I do not envisage a rapid development as regards this point. The uncertainties are many, and extreme care must be taken with statements on the future. Although work will certainly be done on developing prognosis techniques to make forecasting easier, certification of prognoses is unlikely to become standard practice in the foreseeable future.

This will only be viable once the prognosis techniques have been tested and refined, the accountant has added sufficiently to his expertise in this field, and, last but not least, it has really been made clear to the public that the audit certificate does not cover the verity of the prognosis itself but is limited to the validity of the methodology used in arriving at the prognosis and the accuracy of the hard information on which it is based.

(c) Accounting for employees will, I anticipate, increase a great deal in extent within a short time; annual reports for employees will, without doubt, increase greatly in number and quality of information. Accountants will also extend their connections with them still further, both in an advisory and certifying capacity.

(d) Social accounting will be an important topic in the next few years. To begin with, the information in the annual reports will be extended to cover subjects other than those that have been customary in the past and will also be intended for interested parties other than those concerned with financial data (e.g., government, employees, education, research); such things as job opportunity effects, social policy, environmental implications will not be forgotten. This does not mean, however, that a monetary account of social costs and benefits will be possible. Some social costs and benefits are not measurable and cannot, therefore, be included in an account. Attention can and will be paid to them, but in a descriptive way.

Further one may expect - now that the circle of parties interested in information on the company has become so much larger - that investigations will be made into a possibly different approach to the contents of annual reports in general. The accountant will be wise to direct his attention to these problems.

(e) The need for management audits is on the increase. I think that the correct form of reporting in this matter has now been found. Instead of single, general opinions, a description of the strong and weak points in the company is given. Those interested are able to draw their own conclusions. The accountant will, in interdisciplinary collaboration with other experts, find an important and continually extending field of work.