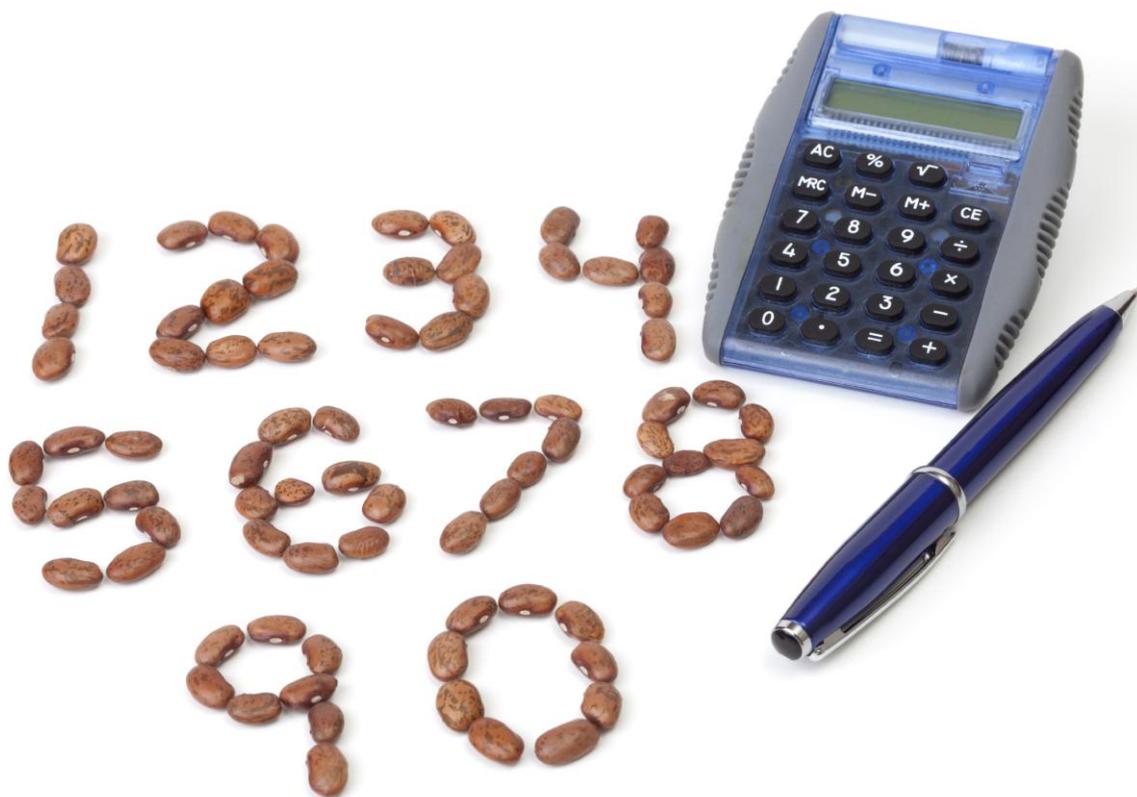


ARE WE  
**ACCOUNTING**  
FOR VALUE?



# ARE WE ACCOUNTING FOR VALUE?

Are the basic accounting principles that have developed over hundreds of years still fit for purpose? **Jeremy Nicholls** of the **SROI Network** argues that they could be reshaped to be more relevant to the global economy.

As we head into the second quarter of 2012 the world economy is facing big challenges. There are immediate economic concerns, as the consequences of the banking crisis continue to affect our lives. Yet there is also growing recognition of the risks posed by social and environmental challenges, by climate change and from inequality.

Over the last couple of decades more and more voices have raised concerns and proposed solutions. Recent examples are Michael Porter's thinking on Shared Value<sup>1</sup>, Tim Jackson's on Prosperity without Growth<sup>2</sup>, and the International Integrated Reporting Council's<sup>3</sup> focus on corporate reporting that demonstrates the links with the social, environmental and economic context within which companies operate.

But there is one area that seems to have slipped under the radar<sup>4</sup> when solutions are being suggested. An area that has profound implications for the way our world works. Yet, from Marx onwards, it hasn't been part of the debate. Why not? Mainly because, as Monty Python's lion tamer reminds us, it is very, very boring. And so it has been left to the experts, our modern day temple priests - the accountancy profession.

Financial accounting is generally thought of (when at all) as a technique: here are some transactions and here's how we account for them. But take away our internationally accepted approach to measuring the financial performance of organisations, from multinationals to unincorporated charities, and what do you think would happen?

Accounting principles did not arrive on tablets of stone, nor were they discovered by an eminent scientist. Most of us will never read a set of accounts - but they are the ghost in a machine on which our lives depend. All the products and services we use are the result of investment decisions that were based on information arising from these principles. This is what makes them so powerful and important. Accounting is one of the great social innovations, an approach that allows us to make decisions based on a reasonable (and audited) application of a set of principles.

Yet we should remember that they are principles rather than truths. Different principles could work just as well as the existing ones. But they would result in different prices, patterns of investment, products and services. Which raises a question: are we sure that this complex accounting structure built on a 900-year-old framework is still fit for purpose?

There is increasing pressure for businesses to provide new information, particularly relating to sustainability, primarily in corporate responsibility reports. Company directors are required to

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<sup>1</sup> [Creating Share Value](#), M Porter and M Kramer, Harvard Business Review 2011

<sup>2</sup> [Prosperity without Growth, Economics for a finite planet](#), Tim Jackson, Routledge 2009

<sup>3</sup> [www.theiirc.org](http://www.theiirc.org), [The Value Reporting Revolution: Moving Beyond the Earnings Game](#), Robert G. Eccles, Robert H. Herz, E. Mary Keegan, David M. H. Phillips

<sup>4</sup> [The Value Reporting Revolution: Moving Beyond the Earnings Game](#), Robert G. Eccles, Robert H. Herz, E. Mary Keegan, David M. H. Phillips

have regard for the impact of their decisions on employees and customers, but also the community and the environment. This trend reflects society's growing concern that the organisations providing us with goods and services should not be doing so at a greater cost to society in the long term.

This has led to some progress, but is it time to go back to first principles and look at accounting itself? Are the basic accounting principles that have developed over hundreds of years still fit for purpose? After all, though most of us think that accounting is about money, it is firstly about people carrying out activities and preparing an account to those who have an interest in those activities.

Accounts are prepared by reference to accounting principles. Of these, three key ones are: 1) the accounting entity, 2) the unit of measure and 3) the historic cost convention.

The principle of the **accounting entity** states that it is separate and distinct from its owners and other firms<sup>5</sup> in order that the entity can provide information to current and future investors and creditors, particularly in relation to the financial value that has been created and could be distributed to owners. This is the basis for deciding what should be included in an account. Investors may want to know about potential dividends and the overall financial position but they may also want to know that the business isn't creating value at a cost to others. Certainly society as a whole may want to know this.

The decisions about what should be included could be based, as is currently the case, on known and probable liabilities. But the accounts could be expanded to consider the effects of the company's activities on all those whose access to resources is affected. Not necessarily to recognise a legal liability to all those affected but to make provision for the effect, to be accountable for them. Uncertainty about the extent to which issues can be attributed to a company's activities shouldn't be a barrier to inclusion.

In some situations such issues are already being considered. For example, mining companies are now required to provide for the costs of closing mining operations that may not be incurred for many years: costs relating to environmental cleanup and possibly social decline.

However, if there were a broader definition of what should be included in the accounts, this would affect company profitability. It would also result in changes in strategy and business models as businesses sought to maintain profitability.

If the accounting entity relates to what should be included, the principles of 'the unit of measure' and of 'historic costs' are about how it should be included.

The principle of the **unit of measure** is that transactions should be included using a standard unit of measure and that the monetary unit is used, which means that accounts will be restricted to those transactions that can be expressed using monetary units.

The **historical costs** convention - costs incurred in the past - is the basis for how items are valued. This has always been difficult since significant areas of financial accounting are not based on historical costs. Many require an assessment of cost (or value) based on a forecast of

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<sup>5</sup> [Accounting Theory](#), Ahmed Riahi-Belkaoui, 2004

the future where costs have not yet been incurred. Think of the provision for bad debts, fair value and depreciation.

The reliance on monetary units in the unit of measure principle may mean that we need to improve valuation - coming up with values for broader issues that have now been identified. Uncertainty of valuation shouldn't act as a barrier to including the value of issues that should be included. Carbon trading and work by the UK Government on social cost benefit analysis<sup>6</sup> show what is possible, but there will be more impacts affecting different stakeholders in different ways, which will need to be valued. Such information would need to be reliable, comparable and auditable at least in the basis for its preparation. In the UK the recent Public Services (Social Value) Act 2012 will provide further momentum for considering these values.

## COULD WE CHANGE FINANCIAL ACCOUNTING?

There are many challenges to deal with here but they are challenges that we surely could address. The purpose of this short article is simply to flag up the issue - and to make the point that in all the discussions and debate about global economic social and environmental challenges, financial accounting principles have not been part of the wider debate.

Our proposal is that there should be a wider debate on:

1. What accounting principles we would want if we were starting with a blank sheet of paper, in today's society
2. How the process by which accounting principles are determined and agreed can be opened up to a wider audience

Recent debates on who has been responsible for the global financial crisis have pointed the finger variously at banks, accountants, investors, rating agencies, customers or regulators. At the same time there is growing recognition of the need for information on wider effects of organisations through initiatives like GRI<sup>7</sup>, IIRC<sup>8</sup>, GIIRS<sup>9</sup> and SROI<sup>10</sup>.

Whether our basic accounting principles are still the right ones and how they are being used needs to be considered as part of both of these issues. This will include addressing the challenges of accounting for, and valuing, the costs and benefits experienced by all those affected by an organisation's activities.

We all have an interest in how accounting meets our needs, and we need to view it more as the public good it is, not 'just' a profession; a public good that should serve the needs of society and not only, as some would argue, the interests of a small group of current and potential investors.

Many of the issues raised in sustainability reporting could be handled within the business value accounts, not in separate documents alongside. Better information should lead to better investment decisions, and higher financial and social returns for all.

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<sup>6</sup> [Social Cost Benefit Techniques: Stated preference, revealed preference and subjective well-being approaches](#), D Fujiwara, HM Treasury and Department of Work and Pensions 2011

<sup>7</sup> [www.globalreporting.org](http://www.globalreporting.org)

<sup>8</sup> [www.theiirc.org](http://www.theiirc.org)

<sup>9</sup> [www.giirs.org](http://www.giirs.org)

<sup>10</sup> [www.thesroinetwork.org](http://www.thesroinetwork.org)

Too good to be true? Perhaps. But it is surely time for a more public discussion on the accounting principles that so fundamentally affect all our lives. And perhaps time for accountancy to be as innovative as it was when it all started. And less boring.

*If you think there should be a wider debate on the relevance and appropriateness of accounting principles or support the proposals for consultation on specific issues, sign up at <http://www.accountingforvalue.org>.*

