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Communications Problems Facing The Practising Accountant As a Financial Reporter

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The most important of the many functions of the accountant, whether he be in public practice or in whole-time employment in industry, is perhaps the effective communication of his ideas and opinion to those whom they concern. Yet this all important aspect of the accountant's work is the one in which the profession has allowed itself most to be tied down by tradition and history and to which the leaders of the profession have devoted least effective attention.

Intelligible financial reporting is needed for a wide rang of differing interests. Present and prospective stockholders, government agencies, economists, national economic planners, creditors, the Press, workers, the public interest and even management make use of such reports and are surely entitled to expect to receive a clear and unambiguous message.

Report on company accounts represent the great majority of the accountant's public communications, and while the accounts themselves are generally the responsibility of the directors the accountant's influence on the development of the art of financial reporting is in fact very considerable and presents a challenge to us all. How are we as a profession meeting this challenge? In my humble opinion the answer must be "Not vary adequately".

Company accounts and reports are, we must remember, presented by the custodians of corporate funds to the owners of these funds and receive wide circulation among the public. These owners and the many other interested sections of the community are entitled to the fullest information which can be given without harming the best interests of the company concerned. They are equally entitled to expect that the information given be supplied in such a form that it can be understood by even the less well educated among them.

The rising standard of living throughout the civilised world in the past fifteen years has had amongst its beneficial effects the introduction to company share owning of hundreds of thousands of individuals who in earlier times had neither the funds nor the inclination to invest in industry. Stockbrokers throughout the world have emerged from their seclusion to instruct the masses in the benefits and machinery of share purchasing. Many of the larger companies have introduced schemes under which their employees are offered as a year-end bonus stock in companies by whom they are employed. Many of these people - indeed the vast majority of them - have no understanding of accounting forms and terminology; the financial reports which they receive as stockholders can have very little meaning to them unless they are couched in non-technical language.

Professor B. S. Yamey, in a paper which appeared in THE THREE BANKS REVIEW (a publication of the Royal Bank of Scotland and its associated banks), wrote: "Company accounting statements are of considerable interest in our economy in which public companies occupy an increasingly important place, and in which the liquidity of their securities has wide implications. A strong case can be made therefore for urging that company accounting conventions and practices, as well as the legal rules concerning the determination of divisible would add to "accounting convention and practices" the words "and language."

What has been done to meet the need of this ever increasing but not financially educated body of stock holders? So far as I can see the answer is "Not nearly enough. I admit that a lot of useful research has been done by some of the accounting bodies, many of whose pronouncements and recommendations have been of great value to the profession and to the public, but the need for a fresh approach in the interests of the growing body of stockholders who lack the necessary financial education does not appear to have been appreciated.

The annual reports issued by an increasing number of companies now frequently contain a certain amount of statistical data, and the Chairman's Statement also adds considerably to the information which can be gleaned from the financial accounts, but this additional information is not generally required either by law or by usage is not reported on by the auditor and only goes part of the way in meeting my criticism. I suggest that as a profession we should use our best efforts to ensure that the stockholder be given all the information which be might legitimately expect to receive and in a form in which he may be expected to understand it. We pride ourselves on being the important - even indispensable -cog in the industrial machine. To maintain this claim we must move with the times and not remain content to act as a steam engine in the atomic age.

The impact of these financial reports on the ranks of organised labour must not be overlooked and it is important that they be not misread and used as a weapon with which to attack the management side of industry.

Where then do we fall down? In what respects are we lacking? Principally, I think in our almost static outlook in relation to the needs of the ever widening class of recipients of our reports. The form of the financial accounts issued by companies throughout the world has changed remarkably little in the past hundred years. It was devised in the days when joint stock corporations were few and far between and when the sector of the community which was interested consisted of a small and select group of highly educated and financially informed men. Changes have, of course, taken place, sometimes as a result of the recommendations of the accounting profession, sometimes as a result of legislation and sometimes in response to public demand. But such charges have been minimal and largely of a practical nature and not resulting from a consideration of the underlying theory. The tendency too has been to go no further than was absolutely demanded.

The profit and loss account or income statement and the balance sheet are today not very different from those produced at the beginning of the twentieth century. They may be produced in a much more expensive, elaborate and colourful form, but their contents have not improved or changed with their outward appearance. A language has been developed for use in these statements which employs words in everyday use in normal life but which attributes to these words and phrases a narrow specialist meaning which is quite often very different from the meaning attributed to them in normal conversation. We are tending to develop a jargon of which we have no cause to be proud. And as though this difference between the common language; were not the specialist language were not enough confusion, even within the

[1] Goldberg: Concepts of Depreciation, 1960 The Law Book Co. of Asatralayia Pty. Ltd. Reviwed in the December 1961 issue of the Accountants' Magazine.

narrow confines of our own territorial boundaries, we accountants are not in agreement to the exact meaning of some of the more important and elementary terms which we employ.

To illustrate my point I would cite as an example the word "depreciation". The man in the street knows and uses this word and knows what it means to him. Two ask two accountants for their interpretation of this word is to invite a discussion of the merits of "historical cost" "replacement value". And "depreciation" is a word which appears in every profit and loss account and balance sheet. Not the chain reaction: "depreciation" affects the amount of the "profit" and of the "book value of the fixed assets".

What message does the reader of such statements receive? He will read the story according to his interpretation of all those everyday terms, and this may not be the story intended by those responsible for it.

About three years ago Professor Louis Goldberg of Melbourne wrote a series of five papers on "Concepts of Depreciation"[1] These have recently been published in book form and highlight the confusion which this one word "depreciation" can cause. In one paper he writes "Let us try to avoid deluding ourselves and others. "If by 'charging depreciation" we mean an allocation of historical cost let us use words (such as cost allocation ...) which will convey this meaning". And he continues "if we mean attempting to provide resources for future replacement" of assets why use words (such as 'provision for future replacement') which will bring this meaning out?"

"Let us not delude ourselves and others". I stress these words because I think this is just what we are doing. We rather pride ourselves on our exactitude, but when we come to think of some of the ambiguities which we perpetrate, I feel that we must blush. Professor Goldberg suggests that more precision in the use of terminology may call for some hard thinking by accountants, and adds in typographical parentheses, "Art not accountants accustomed to hard thinking?". And so we, as individual of a profession which prides itself on its integrity and exactitude, are continuing consciously to use words having to us a definite implication when even amongst ourselves we are not agreed as to the meaning of these words. This double talk does us no credit and must inevitably tend to discredit our pronouncements.

We produce Balance Sheets or Statements of Funds which we do not suggest show the present-day worth of our client's undertaking. Though aware of the fact that the great majority of those who receive these statements believe them to depict the year and value of a business, we do nothing to dispel this wrong idea. This is the position in this year 1962 as I see it; a position which we calmly accept but one which I suggest should not be allowed to continue. All the criticisms which I have so far made can be levelled at the accountants in my country; and I am pretty certain that they are true of most, if not all, the civilised countries where accounting has grown from a common root.

That there has been some concern about this state of affairs is evidenced by the existence of certain articles on Accounting Terminology which have appeared from time to time.

In Volume II of the C.P.A. HANDBOOK reference is made to a plan "to set up a group of representatives of leading branches of society which used terms similar to those used by accountants for the purpose of recommending definition to be used by all. It was believed that if a group of this kind made up accountants, lawyers, economists, financiers, business managers, bankers, labour leaders and investment counsellors would agree on a definition it might be reasonable to expect that all groups would adopt it". This project was unfortunately dropped in favour of another which at the time seemed more urgent.

A significant statement is made in this same publication: "When words have meaning to only one person or to one group of persons they are not useful in statements to be given wide distribution".

The American Institute of C.P.A.s while abandoning this ambitious scheme has issued certain "Accounting Terminology Bulletins" which, however, have a very limited scope and which were primarily intended to achieve a measure of standardisation of terminology within the profession. In 1957 the Canadian Institute of Chartered Accountants issued a book entitled "Accounting Terminology". In a foreword the authors state "It is not the purpose of 'Accounting Terminology' to direct the profession in the use of individual words and new phrases, but rather to define and explain the words and phrases which through continued use have become an accepted part of the language of accountancy. Changes there will be and only acceptance by the profession and by the public it serves will determine what will endure". This book lists and defines 517 words and terms in common use by accountants and is at least a step in the right direction. But unless the definitions be accepted by the members of the profession and become recognised by the general public the real benefit of this advance will not be enjoyed and its effect felt.

The Union Europeenne des Experts Comptables, Economiques et Financiers (U.E.C.) and the Organisation for European Economic Cooperation (O.E.E.C.), now replaced by the Organisation for Economic Cooperation and Development (O.E.C.D.), have also made certain contributions on this theme to which I shall refer later.

If there is any truth in my assertion that the accountancy profession is being less that honest with its readers, it is important that something be done quickly to put our house in order for one very good reason, viz. the development of international trade.

Alexander Graham Bell invented the telephone in 1876; in 1899 Marconi proved that wireless telegraphy was a practical possibility; in 1919 Alcock and Brown demonstrated that a heavier-than-air machine could fly the Atlantic.

These three discoveries have probably done more to shrink the size of the world and to bring the peoples of the earth closer together than all the other advances of mankind. Developments of these three achievements have made the inhabitant of New Zealand the next door neighbour for all practical purposes of the Nova Scotain; have made Madras a suburb of Mexico City.

The effect has been truly dramatic in the world of commerce and industry. The constant shrinking of the distance - in time - between markets between producer and consumer, has improved enormously the lot of both. Were it not for the unfortunately wide gaps caused by nationalism and ideological differences one could hope for the early arrival of that happy day when the peoples of this troubled world could enjoy the mutual benefit of the laborus of all.

The ideas of N.A.T.O., E.F.T.A., and European Common Market, though possibly prompted to some extent by other causes, are developments in the common weal of these discoveries aimed at brining man into closer contact with his neighbour across national frontiers.

In recent years we have seen a growing awareness in the minds of the investing public of the opportunities offered by the stock exchanges of the world. Investment at quite a low level is becoming international instead of local. More and more American securities are being dealt in on European and Asian bourses; Swiss, German and French interests are becoming increasingly conscious of the opportunities offered for sound investment in industry outside the frontiers of their own countries. An ever increasing number of international concerns is investing in business carried on in countries outside their own frontiers, often in countries where the language is not that of the homeland.

One single obstacle above all others which inhibits or retards this very desirable development is the question of language. And by language I do not mean only the national tongue. English is the language of some 350 million people and is the commercial language of probably another 500 million. Can we say that in a commercial sense it is a

common tongue even among the English - not to mention the Scots or Irish?

In our everyday language we, the English-speaking nations, have different words for quite ordinary things. In Britain a flat is something in which one lives, a cuff surrounds the wrist; gas is used to illuminate the streets in some places; a fender is a protection against coal falling out of the fireplace; a depot is a storehouse. Consider the American meaning of these terms! Even in Britain there are variations of meaning from region to region. If English-speaking people have such possible misunderstandings among themselves in everyday domestic matters, how much greater must be the possibility of confusion between them and those for whom English is not the native language? And how much greater is the likelihood of misapprehension when we get into the realm of technical subjects?

We have English/French, English/ Spanish, French/German, etc., dictionaries which give a translation into the second language of the common definitions of most words used in the first language. The need exists for similar dictionaries of accounting terms.

Here then is an opportunity for accountants to do something to bring the business people of the world and others closer together. It seems to me that as a section of the community of man we can do more to achieve this end than any other group of people - and certainly more than the politicians.

Nothing very radical is real necessary; no strongly held views need be sacrificed. All we require is a general acceptance of the meaning of the words which we use in a technical sense. Neither the alphabet; nor the rules of this specialist language have been agreed upon And this is a first essential of a satisfactory atmosphere in which to foster international as well as domestic exchange of accounting information. Without this, confusion must arise. We all know of the trouble which blows up when two teams playing a game obey different sets of rules!

I am not a believer in standardistion of accounting techniques. We practise an art which calls for individual expression of opinion and thought, and I think that it would be a sad day for the profession and, in fact, for the community if the reporting accountant were forced to confirm to a rigid code in performing his function of reporting. We cannot all think alike, and there is generally room for two or more points of view in most matters. We do, however, owe a duty to those to whom our reports are addressed, a duty to make these reports comprehensible and in to way possible of two interpretations being given to them.

This can only be achieved if a common alphabet is employed. The basic terms which we employ should have only one possible meaning, no matter in what language they are expressed. Qualification of the basic meaning could be achieved by the addition of suitable qualifying words.

Mr. Kenneth S. Most writing on 'Accounting Terminology" in THE ACCOUNTANT (March 16 to 30, 1957) says "To make words and figures meaningful is the accountant's task... Although it may not be necessary to invent new terms for the forms and contents of accounts it is most necessary to specify what exactly each shall contain. In doing so current requirements should be allowed to overrule the accumulated tradition". I would substitute the word "made" for "allowed" in the last sentence.

How then do we achieve this end?

We must endeavour to ensure that reporting accountants are awakened to the danger and possible criticism which may arise from the ill- considered use of accounting terms often resulting from a natural desire to reduce to a minimum the number of words used. The growth of technical jargon should be arrested, and the compilation commenced of a carefully constructed lexicon of accounting terms which could be produced in the languages of all countries where accounting is a recognised and significant art. Such a work should be revised by an international panel in order to ensure that the definitions were on an agreed inter-

national basis. Each country would, of course, require to produce its own draft lexicon, and this obviously would be quite lengthy undertaking which would require to be entrusted to a body of responsible members of the profession including both members in practice and persons in other walks of life with similar interests.

The integration of the drafts in different languages would follow and would, of course, be an exacting task which would call for the agreement and acceptance by an international panel of the meaning to be attributed to all terms in common use by the accountant in the pursuance of his function.

Difficulties and differences of opinion would be experienced, but these would tend to emphasise the need for just what I am advocating. These difficulties would arise at the national level, but I cannot see that it should be impossible even for the most dogmatic individuals to devise suitable phrases or terms to meet the different shades of meaning which can be advanced for such words and terms which have a possible variety of interpretations. In the international field there are many differences of opinion on a multitude of matters; tariffs, quotas, subsidies, immigration, armaments, frontiers, etc. So long as these differences exist they cause friction and international misunderstanding - note the word - but most of them have been resolved at one time or another by international agreement and to the advantage both of the countries directly interested and those apparently not concerned. Armaments is unfortunately one of the fields in which agreement has not been reached, but the obstacle has largely been an ideological one. Is no responsible body of accountants willing to initiate international discussion in our particular sphere with a view to permitting understanding to be reached?

As this paper was being written the Union Europeenne des Experts Comptables, Economiques et Financiers published its U.E.C. LEXICON[1]. This is described as "a multi-language dictionary of accounting terms and definitions thereof". It is divided into five sections, these being respectively in French, German, American-English, Spanish and Dutch. In each section the 1,000 terms and phrases are defined and there is given the equivalent corresponding word or phrase employed in the other four languages.

This considerable task is the work of the U.E.C. Committee Lexicologie Comptable. In a foreword it is stated that it is proposed to add an Italian and possibly an English section in later editions. The authors state, "Such peculiarities which are often the cause of incorrect translations are in the field of accounting due to different usage and customs as well as the prevailing accounting theories... This present first edition could not be perfect (in this regard) because the individual terms are as a rule defined only in the language of that country to which the explanation applies... A complete corelating would have required a great deal of additional work which would have delayed publication considerably".

That this work should have been produced shows that some people believe that a need for it exists. It is no doubt one aspect of the closer relationship which is being established among the Common Market countries. All credit is due to the committee for the completion of this first phase of their enormous task. How far the definitions are accepted by the accounting profession in the countries concerned I do not know. It seems to me that an important need is for the committee to sell the idea to the members of the profession in the countries whose representatives have collaborated and then as a final stage to publicise the findings amongst the sections of the community most likely to be interested. General acceptance by the business and professional world of a single definition for any word or phrase used in accounting language should be the ultimate aim.

So far as I am aware, no move along these lines has been made in the United Kingdom nor in North America, even although a section of the

U.E.C. LEXICON is devoted to American-English. This, I suggest, is a matter which should receive the early and serious attention of the leaders of the profession in these two regions.

While little has so far been achieved in establishing a common "language" of accounting terms throughout the world, a certain measure of unanimity has been reached in the form of accountants' financial statements. This is evidenced by the fact that the published reports and financial statements of companies and corporations are framed in the same broad form. This form, the normal balance sheet and income statement or profit and loss account, was evolved in the United Kingdom, was followed in the U.S.A. and Canada and has been adopted in most civilised countries. But an increasing divergence seems to be developing in the principles adopted by different countries in the preparation of these documents. And it is significant that an increasing number of companies is finding it desirable to supplement these forms with a mass of additional facts; statements of cash flow, earnings on capital employed, turnover and expense figures for ten-year periods, etc. Why should this trend be developing? Surely it is the realisation that the stockholder, creditor, potential investor and any other interested party is entitled to more information regarding the concern in which he is interested than is usually given in the normal balance sheet and profit and loss account.

Under United Kingdom statutes certain classes of British companies, including shipping companies, are exempted from giving certain information in their published accounts, such as movement in reserves, etc., which information obligatory for the vast majority British companies. The Jenkins Committee on Company Law heard evidence on this exemption from members of the General Council of British Shipping. One witness, in discussing the potential investor is reported as having said: "The British investor is in no doubt whatsoever what is the strength of the company he is proposing to invest in". This brought the tart rejoinder from a member of the committee: "I have some difficulty in examining the accounts, in forming a view as to the profitability and I can only say, Sir, that I cannot agree with you".

The draughtsman of company reports, be he a company executive or a practising accountant, does not of course, have an entirely free hand in the preparation and presentation of his facts and figures. He is controlled in his function by three main factors, viz. legal requirement the taxation legislation and the recognised standards of presentation advocated by responsible accounting bodies.

While some readers of company reports, such as bankers and financiers, may be expected to appreciate the legal and fiscal conventions which have to be respected in the presentation financial reports to stockholders, the vast majority of the readers, i.e. the stockholders to whom these reports are addressed, tends to interpret the language in such statements according to what one might call "colloquial English¯. Such persons are often not familiar with company and fiscal legislation and are unable to recognise that, for example, the profit disclosed on the face of a profit and loss account is not necessarily and in fact seldom is - the profit on which a company will have to pay income tax. The published profit is arrived at after the directors have made a decision as to the provisions that they consider should be made (irrespective of fiscal provisions), the near capital expenditure which they think should be "written off" against thc year's profits, the sums which they have decided to provide for amortisation of capital or provision for future replacement of fixed assets. The result frequently is that the taxation charge is very different from the figure which would be required if they were applied to the published profit figure the appropriate rate of tax. A random examination of the accounts of six British companies for 1960 shows that the provision for United Kingdom taxation varied as Follows:-

Company
A 40.2%

B	47.9%
C	49.1%
D	50.8%
E	53.1%
F	62.7%

The rate of United Kingdom income tax and profits tax for that year was 53.75 per cent. Obviously company officials must be given freedom to make such provisions in their accounts as they consider necessary in the interests of their companies, but it seems to me that the stockholders have an interest in knowing what is being done. I can see no objection to, and in fact very good reason for, disclosure on the facece of the profit and loss account of significant variations between the taxable profits and published figures. The publication of such comparison might, in fact, bring home to the general public the effect of certain fiscal provisions which can only be described as harsh and restrictive. The resultant public reaction might do more towards amendment of such legislation than the many and oft reported submissions by industrialists and professional bodies.

The past 15 years has shown an enormous increase in the number of "take-overs" in Britain. Many of these have been inspired not so much by the prospects which amalgamation offers of more economical working, but rather by the attraction of large hidden reserves existing as a result of the comparatively low balance sheet value attached to the fixed assets - particularly land and buildings - compared with their real market value. Offers made in pursuance of such bids-have frequently been for many times the balance sheet value of the companies and of the Stock Exchange valuations of these companies. As Lord Kilbrandon, a judge in the Scottish Courts, said at an accountants' dinner in Glasgow a year or two ago "What is the shareholder to think when Pd. 3m. is offered for the shares in a company whose balance sheet shows surplus assets of Pd. 1.5m. and where the directors of that company advise the shareholders that the offer is inadequate, particularly when the balance sheet carries the certificate of an accountant of repute that the balance sheet shows a true and fair view of the state of affairs' of the company?" This statement is specifically called for from the auditor by the Companies Act, though admittedly it is coupled with the words "as shown by the books, but seldom a true and fair view of the state of affairs of a company, which to my mind implies a true view of its value. In the U.S.A. the auditor reports whether the financial statements "present fairly the financial position of the company in conformity with generally accepted accounting principles" or not. In the Netherlands the words used are "present fairly the financial position" of the company. Replacement value is frequently adopted in the Netherlands and may bring the balance sheet figures nearer to present-day value than does the historic cost less accumulated depreciation, but still "replacement value" does not necessarily mean "balance sheet date realisable value".

The trouble springs from the use of words in the auditor's report which are quite inappropriate and in fact misleading. This is a legacy of tradition. The auditor's duty is to report whether or not the books have been properly kept and whether or not the final statements prepared from these books viz. the profit and capital statements, have been properly drawn up from these books in accordance with either statutory or customary requirements. The normal report does not do this. It implies far more than that and in fact could very often be challenged as being misleading and untrue. The remedy is simple. A simple change in title of the balance sheet and recording of the terms of the report- a break-with tradition - would put matters right. Will we as a profession to take the necessary action before the general public start to question the value of our certificates?

The Institute of Directors, London, published a booklet last year entitled "Standard Boardroom Practice". Dealing with Shareholder Relations the authors write, "... directors should give shareholders the maximum permissible amount of informa-

tion about what is happening to their company". And dealing with "The Accounts" they state "The wise board will not look for excuses for keeping shareholders uninformed, but rather for opportunities to increase their knowledge of the company".

While the extent of the information to be given is the province of the board, the practising accountant can use his influence to ensure that the shareholder is not denied any information that he may receive without harm to the company's interest.

There is a considerable amount of opposition to the disclosure of turnover figures, on the argument that such information will be helpful to the company's competitors. It is seldom that this objection can be seriously upheld. With the facilities now available for market research, the information which can be obtained and assessed by intelligent reading of the national and trade press, etc., most companies must have a fairly accurate picture of the progress of their competitors. Publication of turnover would enable interested parties to relate final profit to turnover and might do much to combat suggestions of profiteering. Shareholders too would have a better and more graphic picture of the progress and efficiency - or lack of both - of the companies in which they were financially interested. The issue of quarterly or half-yearly progress reports could be more generally adopted with advantage to the shareholders. Such reports may not be suitable for certain types of concerns, and in business of a seasonable nature can, in fact, be misleading if comparative figures are not given. Twelve months is a long time for a shareholder to have to wait to learn how his investment is turning out. Short-term reports tend to lessen the impact of changing conditions on stock market prices and may even bring to the notice of shareholders weaknesses in management which can be remedied before irretrievable damage is done.

There is a growing demand for directors to give some guidance as to the current value of their company's assets. This demand applies particularly in the case of land and buildings which have a value distinct from their commercial usage. Such information is essential if the shareholder is to be in a position to determine the real earnings of a company's assets. Periodical revaluations of fixed assets on the basis of current replacement cost may be the solution, although it has to be kept in mind that replacement cost is by no means the same as realisable value. In France it is customary to revalue fixed assets in accordance with a government decreed set of indices. This has the attraction that the basis of revaluation is standardised and not subject to the opinion of individual valuers.

To sum up then, while the company auditor's duty is to report to the shareholders on his examination of the books and accounts, his constant endeavour should be to ensure that any information given should be explicit, complete and free from ambiguity. He is in a position where his advice is often sought and he should miss no opportunity of urging directors to take shareholders as completely into their confidence as the interests of the company will permit, He should always keep in mind that the financial statements on which he is reporting will be read by many people to whom they are not expressly addressed. Some of these people may be more easily misled than shareholders who will at least have the opportunity of attending the meetings at which the statements are formally submitted and of asking questions and hearing explanations. Some research into deficiencies of present company reporting, with a view to ascertaining what additional information would be appreciated by shareholders and with a view to removing some of the ambiguities which at present exist, would be a worthwhile exercise.

Serious consideration by research teams of the need for examination of accounting terminology is surely also long overdue in those countries which have not yet faced this vitally important task.

These problems face us a profession. They will not get any less urgent by being postponed. They will not be solved in a year or even in two years. But solved they must be if the accounting profession is the maintain its reputation and its place in the world of affairs. ■