Accounting for the future

It has been said, rather unkindly, that accounting is too important a subject to be left to accountants. Certainly, when it comes to financial instruments treasurers may feel with reason that they should have a say in what gets reported in a firm's financial statements. Many are already concerned with what they see emerging from the standard-setting bodies. Although the Accounting Standards Board (ASB) has yet to make its final views known, it is clear from FRS13 that it favours the use of 'fair value'. Moreover, the ASB's 'Statement of Principles', by endorsing a mixed measurement system, clearly implies a greater use of current value at the expense of historical cost.

There is a need to stand back from this narrow debate and consider the wider issue of what accounting model will be appropriate in future for reporting on a firm's activities to investors and other stakeholders. Some might argue that the balance sheet and profit and loss account, whether expressed in terms of historical cost or current value, have outlived their usefulness other than as a validation of the double entry book-keeping system and to provide an audit trail. It is certainly the case that, for both internal and external reporting, alternative measures and reports are now essential and indeed are increasingly being used.

The complete abandonment of historical cost would be a step too far even for even modernists not least because this convention, unlike current value, provides a vital anchor for historic cash flow analysis, still woefully under-reported in financial statements. The problem with the ASB's proposals is that they attempt to reconcile the irreconcilable by trying to fit new measures of business activity, using current values, into the old templates. This leads to problems. Double entry book-keeping, essential as it still is as a recording system, imposes the straitjacket of balance sheet linked to profit and loss account from which the only escape for the ASB, is the use of the clumsy statement of total recognised gains and losses. An extreme solution might be to 'uncouple' the balance sheet from the profit and loss account but this would have accounting traditionalists up in arms and investors worrying about whether the books balanced!

There are no easy solutions in this search for an accounting model which meets modern needs. Peter Drucker went as far as to suggest that if accounting hadn't been invented 700 years ago and we had waited until the 19th or 20th centuries, most of the today's accounting numbers would show ranges, not precise figures. In other words, like the story of the Irishman giving directions, we shouldn't have started from where we now find ourselves.

There are no easy solutions in this search for an accounting model which meets modern needs

One way forward might be to retain the historical cost financial statements, unsullied by current values, as the stewardship report but to place much more emphasis on cash flow at the expense of the profit and loss account. In addition, firms would be encouraged, and in time required, to develop measures and reports to show a firm's performance and prospects in areas which are not adequately covered in its financial statements, for example, its people, customers and brands. This 'off-balance sheet' reporting could also include the treasury activities. There would be no attempt in accounting terms to bridge the gap between market capitalisation and book value; this is constantly changing and partly dependent on factors outside the firm's control. Why abandon the old accounting conventions or attempt tricks with them which they were never designed to perform? ■

OCEANUS
oceanus@treasurers.co.uk