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## Cost Basis: Accounting's "Samson's Tresses"

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# Cost Basis: Accounting's "Samson's Tresses"

William A. Terrill

## **Abstract**

A weakening of the usefulness of accounting for financial purposes of both management and external interests—and perhaps for the internal performance appraisal activities of company management—is seen by the present author if, through the intermingling of different types of economic data, it should be shorn of the objectivity, reliability, and communicability of historical cost. The viewpoint taken is not that accounting should be restricted in its services, but that it should meet them as a comprehensible and consistent methodology.

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The usefulness of accounting has developed in two major areas, accounting to management and accounting to the public. In considering accounting growth, managerial accounting and financial accounting must be considered together, since managerial accounting exerts pressures for modifications of accounting methodology which may affect the service of accounting to the public and because counter-pressures are exerted by financial accounting which may affect the service of accounting to management.

The basic function of accounting methodology is to produce dependable communication about the enterprise. Dependability of the data presented is important because of the varied group of parties at interest, parties which can be, and at certain times are, in direct conflict. A broad view of usefulness to all these parties must be taken because, if a narrow view of usefulness is adopted which makes accounting subservient to a particular group exerting pressure or to the requirements of a specialized use of accounting data, the service of accounting for other purposes may be seriously impaired and its total area of service substantially restricted.

## **1. Multiplied Demands Upon Accounting**

The outstanding fact with respect to the evolution of accounting is less that the growth has been in response to a need for useful information than that there has been, and continues to be, an ever-expanding group of parties at interest. Both management and the various outside interests believe they see much untapped usefulness in the methods of accounting. Since accounting is admittedly utilitarian, many believe that it should be open to change whenever a new group of potential users see possible adaptations which will make it more serviceable to their needs. Moreover, the present disturbed condition of the world, both politically and economically, increases the search for additional usefulness, since all parties are seeking a more secure basis for economic decisions.

Pressures for the adaptation of the methods of accounting continue because each group is increasingly seeking quantitative data about enterprises and because of the existence of conditions which give the impression that accounting is highly flexible. People at various levels of management, who have derived constant and growing benefit from accounting in providing for the control of operations, for the internal control of the assets of the enterprise and in furnishing some of the data necessary in making various types of policy decisions, feel as a result of their continuous experience that the methods of accounting are highly useful and very adaptable. Many laymen and specialists in other fields, not aware of the problems of measurement and of judgment in accounting and of the need for serving many interests dependably, believe that accounting is a relatively

simple procedure which is easily made accurate and which, consequently, should be adaptable to the measurement and classification of all types of economic data.

The pressure for expansion of accounting methodology to embrace more types of economic data has been aggravated by the lack of distinction between the function and capabilities of the accounting and the functions and potentialities for service of the accounting methodology. Since the accountant is currently being utilized in, and proposed for, a more important economic role, many people believe that accounting can readily be modified to be of greater usefulness in making the enterprise understandable to all, thus permitting the interested and responsible parties to participate more effectively in the solution of many problems of management policy, investment, and of government planning, control, and tax administration.

Finally, a rather broad and indefinite conception of what constitutes accounting data prevails among businessmen, laymen and accountants. To many it is a concept broad enough to include any quantitative data processed by an accountant, including transaction data, standard costs, pertinent value data, cash and other budgetary forecasts, and even statistical adjustment of costs by means of index numbers. Some businessmen, economists, and accountants think that accounting objectives and techniques must be continuously revised to give effect to changes in economic relationships; they claim that the role of accounting in the corporate system and its potentialities in solving some of our economic problems are just beginning to be realized. Some even believe that eventually accounting can help to settle the whole broad question of bringing about economic balance by helping to change the problem of social rivalries from one of emotion to one of fact.

While high goals are set for the potential growth and service of accounting, the development of the methods of accounting and ways of interpreting accounting data have not kept pace with all these aspirations and new needs. Moreover, there is no consensus among industrial accountants, public accountants or academicians specializing in accountancy as to the extent and manner of adaptation that the accounting methods should undergo in meeting changing economic and social needs. Some have advocated various extensions of the area of service of accounting by means of value modifications of account data and interpretative adjustments of cost figures by index numbers, when necessary to supply significant information. Others contend that some adaptations already made are improper and should be discontinued in order to establish an objective base or building further usefulness.

This poses the problem of the extent and type of adaptation which accounting should undergo in order to attain maximum usefulness. In the beginning, the problems of response were comparatively simple but, with the increase in the complexity of economic life, the problems of dependable

communication of information about an enterprise have become correspondingly complex. With a multiplication of uses for accounting data, questions arise as to the limitations or appropriate boundaries of accounting methodology for, obviously, accounting cannot be the one complete and ideal information source for all needs of all interested parties.

## **2. The Nature and Importance of the Demands for Usefulness**

There are many types of demands on accounting for usefulness. Some of these can be met directly by appropriate presentation and interpretation of invested cost data. Other demands require for their satisfaction other types of quantitative economic data, such as special types of value, current “costs,” or future “costs.” These may be used to satisfy certain demands either instead of, or along with, invested cost data. Certainly an attempt should be made to meet all these demands. The question raised is, “To what extent should these other types of economic data be encompassed in accounting methodology and expressed as account data, and to what extent should they be kept separate and distinct?”

This question cannot be answered satisfactorily unless a broad view of usefulness is taken and the nature and significance of each type of usefulness understood. The following classified list of uses indicates some of their characteristics which are important in providing an answer to the foregoing question:

### 1. Central and continuing uses:

- Presentation of a dependable record of assets (productive factors), equities and income in financial reports
- Measurement of overall enterprise performance and the performance of functional sub-units of the enterprise
- Study of cost behaviour to assist in cost control
- Internal control

### 2. Auxiliary repetitive uses:

- Budgeting
- Setting of standards
- Quantitative support to facilitate profit planning and in making specific management decisions of limited scope
- Tax reports, including taxable income determination

3. Auxiliary special uses:

- Special reports – realisable value balance sheet for certain financial difficulty situations
- Statements showing effect of price level change
- Special justifications – Quantitative support for recommendations on price policy, financial policy, labour policy, and tax policy

These uses will be considered individually and in their relationship to the total pattern of use as the pressures for different types of expansion are discussed. With the central and continuing functions and auxiliary functions in mind, it is possible to make a better appraisal of the suitability of various directions in which expansion of accounting methodology is sought and to gain enough perspective to see the boundaries which are appropriate to the primary functions of accounting and which will enable it to maintain its present usefulness and also provide the basis for additional primary or auxiliary service.

### **3. Cost Basis Needed for Reliability and Effective Communication**

The organisation of a business enterprise (or entity) is usually in one of the following legal forms: single proprietorship, partnership, or corporation. They serve the social function of bringing people together so that the efforts of groups may be combined and directed toward common objectives. It is necessary the measure separately the operating results of each entity, its financial position and the custodianship of its tangible properties, as a unit separate from individuals or groups who provided the financial resources. This entity is a focal point of the interest of various parties. If the private economic activities of the owners, of credit suppliers, of customers or employees, were part of the accounts of a particular economic unit, this circumstance would certainly produce a blurred picture. What is needed is a distinct picture of the economic unit as such. The accountant refers to the unit for which an accounting is made as an accounting entity.

The accounting entity is an abstraction, but one definitely relating to a significant and concrete segment of the economic system. It is certainly a necessary abstraction when considered from the communications viewpoint. Accounting is part of an information service. It provides an accounting for a specific, definite entity. Without this conceptual device, an accounting for an indefinite segment of economic activity would be the alternative. Such an accounting would be impossible to prepare, undependable, and confusing or useless to the various interested parties – management, creditors, stockholders,

investors, and governmental agencies. The scope of the entity concerned is basic to the understanding of any report upon it. A report of operations which was not given a title would be useless because not identifiable with an economic unit. The boundaries of the entity must always be kept clearly in mind in recording and reporting if a dependable accounting communication is to be achieved. The outline of the entity marks the boundaries of the data which should be included in its accounts and gives the principal due to data which should be excluded. The entity device is an aid to dependability and communication and, at the same time, may serve as the basis for the distinction of data which are external to the enterprise and, therefore, different in nature. Such external data are not thereby labelled insignificant but rather as different from data which have been produced by the transactions and productive actions of the enterprise.

The idea of the entity is fundamental for the starting classification of facts relevant to the enterprise. However, it must be supplemented by other devices and procedures to support the dependability and improve the communication of accounting data. The entity device aids objectivity by establishing in an impersonal way, not subject to arbitrary opinion in each situation, the boundary for data which may qualify as account data for the particular enterprise. The further requirement of actuality, as evidenced by the committed acts of the entity in its business transactions with outsiders, provides protection against the inclusion of supposed effects on the enterprise which would tend to be highly subjective.

The entity device and the restriction of account data to actual business transactions are facilitating factors in obtaining an adequate and independent review of the operations and conditions of a business. Since the auditor's area of responsibility is defined by the boundaries of the entity, he can develop a thorough and integrated audit program for satisfying himself that the underlying accounting records are objective and complete. The restriction of accounting data to actual, objective business transactions makes a review possible, and capable of being independent. It is impossible to review potentialities, intentions of enterprise management, and the degree of correlation and effect of external current circumstances on the individual business entity. Actuality (actions of the entity) can be reviewed because supporting evidence has been provided by the action itself. The requirement that the facts basic to accounting reports be reviewable and be reviewed, adds materially to the user's belief in their dependability since it insures greater accuracy and a minimization of the effect of non-accounting motives.

Communication likewise is aided by the utilization of the entity device. It provides the framework for a distinct picture, but it alone is not sufficient and must be supplemented by other factors in achieving a high degree of communication. Money-price representation makes possible orderly recording and

summarization and provides a means of comprehension of the extent of ownership of diverse objects and claims. Also, since money representation is in accord with the common and legally sanctioned method of measuring business activity, the non-expert user of financial statements, along with the more qualified analysts, can derive some useful information from reports presented in familiar terms.

Consistency through time and among various enterprises aids communication by providing greater comparability. Consistent treatments and disclosure of the various classes of elements in all financial statements leads even the occasional user to a better appreciation of the basic financial aspects of business activities and their results. Consistent treatment and disclosure are more likely to occur if they are based on an integrated theory which is directed toward the achievement of the primary function of enterprise accounting – the measurement of the productive factors and the effectiveness of their utilization in accomplishing the enterprise purpose. The development of an integrated body of theory which is internally consistent is not possible if usefulness of information is the only accepted accounting objective.

In order to provide useful quantitative measurement to assist management control and protection of the various equities in all possible situations, accounting would have to encompass the entire field of value. The purposes for determining value are so manifold that it is impossible to construct an internally consistent body of accounting theory centred about value in general. If each use of accounting information had its own set of principles and procedures, there would be greater freedom of adaptability and perhaps greater usefulness in a limited area but broader usefulness would be sacrificed. Some function of accounting must be selected as central if accounting is to have broad and continuing usefulness. If the purpose of the accounting is not clear and is subject to change from time to time as different areas of value representation are selected under the pressure of special needs and if the basic data can be recorded under several different systems and theories, it is obviously more difficult to prepare reports which interested parties can understand and interpret intelligently and in which they will have confidence as to reliability. The acceptance of a central and continuing purpose is necessary to the formulation of an integrated and internally consistent body of theory which, in turn, can facilitate the attainment of greater dependability and dearer communication.

For any individual enterprise, invested cost data have substantially different characteristics from other data related to the enterprise. They differ substantially in relevance, timing and reliability. They are more relevant to the enterprise because their relevance has been demonstrated by the committed actions of the enterprise. As to timing, they have probably affected the enterprise and are not "might-have-been", "might-be", or "will-be" effects on the enterprise. Their reliability is supported by the fact that they originated from transactions

between independent bargaining units and by validating their completeness and subsequent treatment through competent independent review guided by professional standards.

#### **4. The Difficulties and Dangers of Accounting for Value**

One of the pressures for expansion of accounting toward what some extend will be greater usefulness involves expansion beyond the enterprise entity as the limit of relevant data. In securing a broader base of information for decisions by management or outsiders, economic information of significance can be derived from many sources. Examples are market values and liquidation values of certain assets, changes in general price level and specific price levels bearing a closer relationship to the activities of the enterprise, trends in the specific line of business of which the enterprise is a part, and the trend of business activity in the total economy.

There are constant and intermittent demands that accounting go outside of the boundaries of the entity for information of some significance to the enterprise entity. There is a justifiable and continuing demand for information concerning value. The market value of certain assets, such as marketable securities and merchandise inventory, is desired as significant information by banks and suppliers so that they may have better knowledge as to the degree of liquidity of the enterprise and magnitude of its liquid resources. There is an intermittent demand for information as to the value of fixed assets. This is of some importance to financial management in times of rising prices when decisions must be made concerning the retention of earnings to maintain productive resources. It is also of some importance to creditors when the enterprise is seeking additional financing through an issue of long-term bonds, especially mortgage bonds. There are also some legal situations, in which the law is involved in protecting the rights of various equity holders, which require value information of special types – current appraised value and market value to measure the magnitude of the dividend base and realizable, or liquidation value under the circumstances of receivership or liquidation. Finally, economists and statisticians, in collecting data for the computation of national income, desire market value information in order to arrive at the net value added by the productive activities of each enterprise.

However, the area of interest in value is very broad and indefinite. There are many different types of value with special meanings denoted by appropriate attached adjectives (such as market, going-concern, assessed, sound, liquidation, and replacement) aiding the understanding of their precise meaning in line with the special purpose for which value is being determined. A consideration of some of the characteristics of value which are common to all its meanings, other than invested cost or exchange-price value, indicates the necessity of distinguishing

other types of value data from invested cost data. Value is subjective, variable and involves an appraisal of the future. It is highly subjective because it involves the mental process of inference, which is chiefly dependent upon an individual's opinion as to the similarity of two situations in regard to the specific circumstances of time, place, identity of commodity or property, and the purpose of the valuation. It is variable because it is an expression of individual opinion dependent upon changes in surrounding circumstances and the special purpose of the valuer. It indirectly involves appraisal of the future since it is derived from anticipated demand for a product or property, expected usefulness to a present or prospective owner, or potential profit or earnings to be obtained through use or sale. It is impossible to trace through time the causes of the changes in value information relative to specific assets. Most of those causes lie outside the enterprise and are not under the control of enterprise management.

Since value is impossible to trace within the entity and account for continuously and since many types of value are not continuously significant anyway, it seems that value information can best be treated outside the accounts. To inject value information into the accounts confuses the service which accounting renders in providing information needed to measure performance and to aid in the control of operations, and thus it impairs the present and future usefulness of the account data to management and to most outside parties. Value data have significance for certain interpretative purposes, but the differences in the reliability and relevance of these data indicates that, for the broad general usefulness and long-run usefulness of accounting to management and accounting to the public, some items must be pointed out as external economic data (beyond the entity) and not of the same nature as invested cost data, enterprise accounting facts, or account data.

## **5. The Difficulties and Dangers of Accounting for Price Level Changes**

Another pressure for expansion of accounting involves expansion beyond invested dollar representations to include index representations. During the inflationary years since World War II, there has been a growing belief among the users of accounting data that the information presented was less significant and less dependable because accounting measurements were in terms of dollars recorded at various past dates and that, therefore, those dollars failed to reflect the change in the purchasing power of the dollar since those times. Many businessmen, economists, and some eminent accountants have contended that the adjustment of accounting to measure the economist's idea of real income would be desirable.

The simplest way to convert a money measure into the economist's "real" measure is through use of an accepted index of the general price level. However, the immediate discovery is made that price indexes are not perfect measuring devices either. Economists admit that no perfectly satisfactory index of the general price level exists, because of poor price reporting and inadequate coverage and, also, because in theory it is impossible to construct a perfect price index no matter how much information one has.

Another difficulty encountered is the recognition that there is not one price level but many. Since any individual business does not expend its liquid resources for all the items embraced in the computation of a general price index, there is a strong argument to adjust for purchasing power in the light of the use to which the purchasing power will normally be put, that is, to use an index bearing a close relationship to the activities of the enterprise. Thus a dilemma is created, since the application of a broad general index to the account data of an individual firm may result in distortion rather than significant interpretation, while the application of a more specific index selected by management makes possible some manipulation and would make comparisons between companies still more difficult than at present. Any interpretative adjustment made by the use of index numbers might be useful to management for certain purposes and helpful to the economist compiling and interpreting industry, regional and national data, but the additional complexity injected into the reporting of income would reduce comprehension of the reported data by most outside parties, since it would be a radical departure from generally understood method. Furthermore, in striving to get consistency of one type within an individual enterprise – the matching in each period of revenue and expense dollars having equivalent purchasing power – it appears that some new problems of attaining consistency among enterprises may be created unless the use of a particular index is mandatory, and that would bring its own troubles.

Most of the proposals to reflect the effect of the changing value of the dollar do not attempt to portray the full impact of inflation on the enterprise. No consideration has been given to the off-setting effect on costs and financial position due to the fact that some of the liabilities will be paid off in dollars which are cheaper than when the liabilities were incurred. Omission of such consideration not only results in failure to attain the initial objective but also in justifiable criticism by labor, tax authorities and others that such omission is the equivalent of manipulation.

It is conceded that management, during inflationary times, is indeed under the press of short-run considerations in the execution of its responsibility to administer income – the drain of taxation, the needs of financing dollar and physical expansion, the maintenance of dividends, and the demands of labor for increased wages. Having focussed their attention on these problems which demand immediate solution and being impatient with the slow processes of

changing laws and of public relations, some feel that change in accounting methodology is preferable to a longer and more difficult, yet more basic and stable, solution. The management of an individual enterprise may seek tax justice by the restatement of its cost through the application of index numbers, but the same management would probably not offer to restate the dollars it owes to creditors.

Accounting methods can insure neither business enterprise debtors, nor creditors against risk due to monetary fluctuation. If injustice is being done to any of these because of contracts made before monetary fluctuation, it should be alleviated by tax law change, by encouraging the use of security contracts which provide for repayment in equivalent purchasing power, or by national legislative action for revalorization of assets and debts in terms of coefficients established by relating the value of the monetary unit in various prior years when assets were acquired and debts incurred to the currently established value of the monetary unit. The means of attaining greater financial justice in times of monetary fluctuation are dearly in the field of law. Accounting is neither a short-cut to justice nor is its modification an appropriate substitute for legal modification.

If successive index number interpretations were made directly in the accounts, accounting data would gradually be separated from their basis of dependability – the actual business transactions of the entity. Furthermore, there is no way that the method of computation of an index or its applicability to the entity can be satisfactorily reviewed by the independent public accountant. If there is no reasonable assurance as to the dependability of the interpretations made, they will not be: used by outside interests in making their decisions related to the enterprise and the continuing usefulness, for management purposes in measuring performance and cost control, that was in the basic account data will have been sacrificed.

In view of all the difficulties and losses in usefulness involved in price index adjustment, accounting should not sacrifice the advantages of money representation. The monetary unit is not suited for all types of economic measurement but it has much to recommend it. It is the unit in which business transactions are discussed and recorded and thus provides a logical starting point in improving understanding. Not only is a careful accounting in dollar measurements necessary to facilitate understanding and belief in dependability, but it is also mandatory as a base if any price level adjustment is to be made. A complete record of transactions and dates must be available for converting recorded dollars to a common purchasing power denominator. The limitations of money representation caused by changing price levels should be mitigated by interpretation, but any interpretation by means of index numbers should be clearly disclosed as such and kept distinct from the array of recorded accounting facts, the account data.

## **6. The Difficulties and Dangers of Accounting for Potential Costs**

Another pressure for the expansion of accounting involves an expansion beyond actuality into potentiality. Management's job is guidance toward the future and so it is natural that it seeks some quantitative data as part of the base for its guidance and as support for its decisions. Business executives feel that this can be found in a more scientific, quantitative approach to economic activities and their control. For the area of financial decisions, accounting has seemed the most readily available and adaptable technique. Hence it has had new demands for extended service and modification.

It has been contended by businessmen, economists and accountants that it is future costs (potential or replacement costs) considered along with expectations of future revenue, that are effective in business policy determination. Businessmen have persisted in their attempts to modify the conventional exchange price account data in various ways (last-in, first-out inventory method, and depreciation on replacement cost) so that data for pricing policy and various phases of financial policy are automatically made available to them in the accounts and presented to outside parties. Management believes that, if the basic financial problem of maintaining the resources of the enterprise is presented to the various elements of the public by reflecting replacement costs in the published reports, stockholders will make more reasonable dividend demands, labor will make saner wage demands, and income tax policy will be formulated which will permit enterprise maintenance and growth.

Certain difficulties and probable losses of usefulness raise serious objections to the acceptance of potential data, such as replacement costs, into the accounting framework which is used as the basis for accounting to the public and accounting to management. One difficulty encountered is that, in order to obtain future replacement cost data, so many new variables and imponderables (highly subjective estimates as to the timing and type of replacement and the probable prices then effective) must be considered that any estimates made are of doubtful reliability. It is almost impossible to get a solution which will be dependable and be sustained by the subsequent replacement experience.

Measurement and the review of that measurement are indispensable characteristics of usefulness, especially in accounting to the public. When measurement is almost impossible, and if those made cannot be corroborated by independent review (since an examination and validation of intentions is impossible), it seems illogical and misleading to intermingle such data with the actual account data. For comparisons between companies, it is apparent that there

would be a loss in usefulness, since another element of inconsistency in accounting practice would be introduced. This would arise from the considerable variety of practice in estimating replacement costs because of the varying degrees of competence, integrity, and thoroughness of study by financial management, accountants, and engineers of different enterprises.

Because management's interest in the modification sought is not only for its own guidance but also to develop a more persuasive argument in quantitative form to counter or minimize certain financial pressures, some slight bias and various degrees of manipulation would be inevitable. Accounting cannot be a wishful advocate of management and exert influence for the self-interests of management in the solution of enterprise problems. To be influenced by management or any other party automatically restricts the usefulness of accounting to other parties. Under the contemporary economic circumstances and the existing relationships between management and labor, management and stockholders, and management and the government, accounting modifications cannot be sought on the basis that they will enable one party to convince the others of the reasonability of its decisions. The purpose of accounting is not the advocacy of the position of any of the interested parties. Any hint of advocacy, especially in the methods selected to determine income, only aggravates any existing distrust among the various parties and leads to disbelief of the data presented.

If potential data are merged into the same framework with actual data, some losses of present usefulness occur and some new difficulties are encountered. It is obvious that accounting becomes less useful as a device for accountability. Individuals or groups of individuals with financial responsibility can only be held accountable for their actions, not for what they might have done, for their intentions, or for actions or conditions external to their prescribed area of responsibility. Serious loss would also occur in a type of usefulness of constant importance to management, that is, the determination of cost performance and the responsibility for that performance. The mixing of actual and potential data in the accounts would seriously impair the validity of the data and its interpretation through study of cost behavior as the basis for any control action to be taken in regard to men or materials.

Moreover, modification of accounting methodology to include replacement cost data does not provide a real solution to two aspects of the basic problem of maintaining the resources of the enterprise. One aspect is that of convincing certain distributees that there is a justifiable need for retaining earnings. Under contemporary circumstances, such accounting modification would only aggravate distrust of management and disbelief of the data presented. The second aspect is that of replenishing or increasing the dollar resources of the enterprise. If the resources of the enterprise are to be maintained in the sense that

liquid resources will be available for the replacement of existing inventories and productive facilities, there is a problem of proper pricing policy so that revenue assets will provide additional dollar resources, or a problem of financial policy to provide new sources of additional dollars through bond or stock issues. A change in accounting policy will not provide additional dollars. Since the inclusion of potential data within the accounting framework cannot provide direct solutions to management pricing and financial problems and such inclusion would cause serious losses of existing usefulness, the distinction between actual enterprise data (account data) and potential enterprise data is appropriate and necessary.

## **7. Satisfying Varied Needs by Distinguishing Types of Economic Data**

After consideration of these various types of expansion of the services of accounting, it becomes increasingly clear that some of the concepts and methods which have been put forward in the name of making accounting more serviceable are capable, if adopted, of impairing the primary services which accounting has been rendering for a long time. There is a real danger that, without a critical examination of suggested modifications, the core of accounting usefulness may be extracted in a blind search for more extensive usefulness. Since accounting cannot meet all the individual needs for information fully, its primary communication function should be to present dependable and basic information about the enterprise, which can be of substantial usefulness to all interested parties.

The reason for existence of enterprise economic units is to serve some productive purpose. Hence, creditors, investors, employees, consumers, and the government have a continuing interest in the manner in which this productive purpose is carried out. If a maximization of usefulness of accounting is sought, it seems that all parties can be directly or indirectly served, without prejudice to the information needs of any, by presenting facts concerning the accomplishment of the enterprise productive purpose – the details of actual expenses, losses and revenues, and the net income result. Inasmuch as some of the parties using income statement information have opposing interests, it is important that the elements of income determination be measured as objectively as the internal factors of dependability, combined with professional competence and judgement, can make them. Dependability cannot be achieved if value modifications, index number interpretations, and potential cost figures are intermingled with the account data which have important differences as to timing, reliability, and relevance.

Critical examination of the modifications advocated not only reveals the possible dangers of such expansion but suggests alternative means to satisfy the fundamental objectives underlying the pressures for expansion. The proper

approach to establishing a framework which will provide for the maintenance of present usefulness and will provide the basis for meeting expanded needs is to stake out carefully and clearly the boundaries of the area of service of accounting and the information it properly channels and summarizes and to delineate the other types of economic data which are of some significance to an understanding of the enterprise but which have important differences in the characteristics of timing, reliability and relevance. In this connection, most literature uses the term, accounting data, quite broadly. If the data are quantitative, useful and prepared by accountants, they are referred to as accounting data. Thus, the term has gradually embraced economic data of widely varying characteristics. By making all interested parties aware of the different characteristics of these economic data, more effective communication can be accomplished and greater confidence in the dependability of the basic accounting information can gradually be established. Therefore, it is recommended that the different types of accounting data be carefully distinguished. These distinctions can be broadly summarised into the following three:

1. Account data – those data generated by the transactions and the operating actions of the enterprise.
2. Potential enterprise data – those data which are useful to management and internal to the enterprise but which are generated by prediction, such as standard costs and replacement costs.
3. External economic data – those data which are useful in interpreting account data but which are beyond the scope of actions and responsibility of the enterprise, such as value data and index numbers.

Accounting methodology, especially for accounting to the public, should be delimited to deal only with account data. This will emphasize to all parties that accounting provides primarily account data which has special qualities related to dependability and communication which have been developed out of long experience and cannot be dispensed with without serious loss in usefulness. Accounting should meet the new and expanded demands for service by improving its presentation of the actual enterprise account data and by correlation of these with potential and external information which are deemed to be of significance in interpreting current financial status, financial needs, and results of operations. This correlation can be accomplished either through additional columns inserted in traditional statements or through supplementary interpretative analyses which are tied into and reconciled with the basic accounting statements.

This approach to usefulness is substantially, but not sufficiently, recognized in practice. The fact, that certain departures (the use of cost-or-market valuation, depreciation on replacement cost, the last-in, first-out inventory method and accelerated depreciation regardless of the physical facts of operation) have been practiced rather widely, has brought accounting under severe criticism.

Proposed modifications and excursions for some data beyond the entity and into the external, beyond the immediate past and into the future, and beyond money-price representation to statistical index number representation would further impair belief in dependability and cause serious losses in types of usefulness which accounting has been rendering for a long time.

In order to restore and maintain belief in dependability, the statements presented to the public must clearly rest on a base which is as objective as the factors of dependability and competent professional judgment can make it. That base should be composed only of account data. Once dependability is established, then the expansion of usefulness is possible by teamwork with those working in neighbouring fields (economics, statistics, and law) through providing as distinct data those items which will enable them to implement their concepts and methods to attain their special non-accounting goals.

In essence, it seems that accountants would be wise to enter rapidly upon such modifications of their art as would make it more understandable and dependable without changing its fundamental base or function, and that they could profitably engage in a continuous, well-considered effort of public relations designed to explain the nature, boundaries and service of accounting methodology in accounting to the public and accounting to management. An increased understanding of the characteristics necessary for the primary service of accounting in providing dependable communication about the enterprise, especially in relation to income determination and the measurement and control of performance, and an increased understanding of the resultant necessity for distinguishing between account data, external data, and potential data, will help clarify to all users of accounting data the types of primary service and auxiliary service which can be rendered by accounting.

### **Biographic Note**

After his undergraduate training in the University of Cincinnati's School of Business Administration (1933-1938 and 1940), William Adolph Terrill (Cincinnati OH, 7 March 1916 – Chapel Hill NC, 5 June 1974) enrolled in the University of Illinois in October, 1947 to begin graduate work in accountancy, and at the same time received an appointment as an Assistant in Accountancy there. The degree of Master of Science was received in January 1949 with a thesis devoted to "*Depreciation problems related to the controversy over restoration of fixed assets.*" Since September 1951, he has been appointed in the school of business administration of the University of North Carolina at Chapel Hill, where he taught management accounting theory and methods, whilst he received the PhD degree from University of Illinois in 1952 with a thesis devoted to "*Factors which modify the area of service of accounting-to-the-public*" under the supervision of Professor A. Charles Littleton. The National Association of Accounting awarded him its Lybrand Certificate of Merit for "the outstanding character and excellence of his contributions to the literature and advancement of industrial accounting." He was national vice-president of the American Accounting Association in 1965 (provided by Yuri Biondi).