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PATTERNS OF ACCOUNTING ACTIVITIES

by
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[Introductory note: Professor Louis Goldberg was educated at the University of Melbourne, where he received the degrees of BA, MCom, and LittD and where he was Professor and Head of the Department of Accounting from 1955-73.

Before he became the first full-time academic in accounting in an Australian University in 1946, he had extensive practical experience in public, industrial, and governmental accounting. He has written several books and many articles, papers, and chapters of books. His books include a *Philosophy of Accounting*, *Concepts of Depreciation*, *Elements of Accounting*, and the AAA Monograph No. 7, *An Inquiry into the Nature of Accounting*. He visited the United States as a Rockefeller Foundation Fellow in 1955 and as a Fulbright Fellow in 1963, when he was visiting professor at Baruch College. In 1970 he was visiting professor at the University of Florida.

note: In his lecture Professor Goldberg points out that the work of accountants can be discerned as conforming to a number of patterns applicable to the tasks of recording, measurement, and reporting, and that the complexities of present-day accounting arise from the interrelation and interaction among these patterns.]

I am concerned -- and have been concerned for some years -- in studying accounting theory, especially with the implications of one word -- the word "why." That is, I am interested in explanations, and, as I see it, a theory is some form of explanation in terms of a kind of generalization which is applicable to more than a very few phenomena.

The title of the lecture, as announced, is -- perhaps rather vaguely -- "Patterns of Accounting Activities"; but what I really mean, I suppose, is "patterns of accountants' activities." I have one basic premise, with which I think you'll agree, and that is that accountants are people. (And most of them, in my experience, are, really nice people.) They are people, and, as people, they do things; and the things they do are what I am interested in considering.

Accountants are measurers, recorders, reporters, and interpreters. This does not mean to say that they are bookkeepers, but they are responsible for designing and installing records and having them maintained. They are responsible for the preparation of reports derived from the accounting records and data, and they carry out the function of interpretation of reports, transactions, and events. What is it, then, that accountants record and measure and report about and interpret? Let us try to look dispassionately at what accountants do in their day-to-day activities -- or at least with as much uncolored attention as possible; I don't suppose that we could be completely unbiased, but we can try to be, and we can try to avoid emotional and evocative impulses arising in us to color or distort any sort of picture we get. If we do that, then I think that some patterns of accountants' activity can be discerned.

One of these patterns was pointed out in *An Inquiry Into the Nature of Accounting* (1965 American Accounting Association Monograph #7) and it may be of interest to indicate this because it may have some bearing on part of the discussions that are currently taking place by your Financial Accounting Standards Board on the "conceptual framework for accounting and reporting."

The pattern of accountants' activities that I referred to in this book is that of being based upon events: the phenomena with which the procedures and practices of accountants are concerned relate to happenings that take place--occurrences -- and I called them "events." Any accounting report, in whatever form and in whatever terms it may be expressed, is a summary of things that have happened or the results of things that have happened. In the case of an income statement we have a summary of what has taken place -- the various activities, transactions, and so on--during a given period. The balance sheet, or, as it is frequently called nowadays, the statement of financial position, expresses the results of things that have occurred in the past. Another report, the statement of changes in financial position, which we used to call a funds statement, is also a statement of things that have happened during a period. So it seemed reasonable to me to seek a unit of activity in terms of which accounting procedures may be considered to be carried out. The term "event" was assigned to this sort of individual unitary bit of activity. You can all think of examples of events: payment of a check, receipt of a dividend, the deposit of a number of checks in a bank account -- these are all separate events. Purchase of a commodity, sale of a commodity, and so on, are all events too.

Not all the events that take place within a given social unit or economic unit would necessarily be accountable in the sense that they could be brought into the accountant's procedures. The managing director drinking his morning cup of coffee is an event, that is, something that happens, but it does not necessarily have to be brought into the accounting record. At the same time it is at least conceivable -- and I really think it likely -- that many more events than are presently accounted for could be brought into the accounting procedure. I leave that matter open for the time being. For the present we have this basic unitary notion of events.

The next point is that a series of events -- a minimum of two, but very often many more -- linked by some common measure and some social or economic objective into a relationship which has some meaning, constitutes what I called a "venture." For example, the receipt of a quantity of goods and its piecemeal issue to various production jobs until the whole quantity has been disposed of would constitute a venture. The acquisition of the initial quantity, say, of 100 yards of material would be one event; the issue of 25 yards to Job X would be another event; the issue of 40 yards to Job Y a further event, and so on until the whole 100 yards had been used up. This series of events will constitute a venture. The purchase and sale of a particular commodity would be a simple example of a venture.

These examples are simple and straightforward and constitute what I labeled "determinate" ventures. I used the term "determinate" because I felt that they had limits, that is, terminal points; each of them had a beginning and an end, and we could say, in effect, that in this sort of venture, one starts the venture, and after a series of events the venture is finished. But many series of events are not so easy to determine, in the sense of setting boundaries or limits to them. To give an example, consider the acquisition of shares of stock in a company. Dividends are received on the shares, maybe regularly or maybe irregularly; the amounts of the dividends may be subject to fluctuations. The shares may be disposed of after a short period, or they may be held for a long time, or they may be transferred from one shareholder to his heir or to a trustee of his estate after his death for the purpose of holding them as a charitable trust in perpetuity. In a case like this the series of events does not have a determinable future end. And a number of ventures are of this indeterminable character. Hence, the second type of venture that I distinguished was that of "indeterminable" ventures.

The difference between a determinate venture and an indeterminable venture is one of degree and, basically, one of time. There will come an end to that shareholding eventually when the company goes out of existence; there will be an end to a particular holder's shareholding in a company, for when he dies his shareholding will cease. But it is nevertheless convenient to make a distinction between

determinate and indeterminable ventures when we are thinking of the activities of particular people or legal persons. The activities of a corporation, until it has ceased to operate or until cessation is envisaged, may be regarded as comprising an indeterminable venture. When a corporation is started, it is normally hoped that it will go on indefinitely. But at some time or other, at an indeterminable point in the future, it will end. So, within this indeterminable venture which comprises the life of a corporation-or any other social enterprise-there is a vast number of determinate ventures going on day by day, week by week, month by month, starting and finishing, overlapping and interacting.

What the accountant is trying to do is to segregate these ventures, to record the events in each of them, and bring the events into relationships with each other. At the same time he has to be able to keep the record for each venture separate from those of other ventures so that the story of each venture may be picked out and told, as well as the story of the combination of ventures for a given period -- for example, yearly. From this point of view an income statement becomes a summary of ventures, some of which have been started during the period, some of which have been completed during the period, and some of which are incomplete at the end of the period. The accountant's task is to sort all of this out.

Ventures are of different kinds, and I was able to distinguish five types. There may be more, but I think there are at least these five.

The first are *trading* ventures -- the acquisition and sale of a commodity, with a resulting profit or loss on the venture. The basic pattern is that a commodity is acquired at a cost of, say, x dollars and sold for y dollars, the difference between x and y representing a profit or loss. The fact that in many cases there are additional charges-costs of manufacture, distribution, advertising, selling, buying, freight, and so on-to be taken into account means that the venture is more complicated in detail, but it does not affect its basic pattern, namely, that you are buying something and selling something. You may be converting the thing you buy into the thing you sell by manufacture or by relocation, but it is still a trading venture. This pattern occurs in accounting procedures under a variety of disguises, apart from straightforward purchase and sale: it occurs in consignment and joint venture accounting, job cost finding, liquidation, and realization accounting (in the case of bankruptcy).

Second, there are *usage* ventures. An article is acquired and is used for a more or less specific objective, and the elemental pattern is of this form: of 100 units of a commodity, 40 are disposed of on objective A, 25 on objective B, and 35 on objective C, so that all the units are disposed of. This pattern will be recognized as applying to inventory records, live-stock accounts, and of course, long-term asset accounting. What is usually called depreciation could be ex-pounded in this way by saying that when a machine is acquired it represents a certain quantum of units of service which are allocated on a usage basis to relevant objective, and in many cases time is an approximation to usage. That doesn't explain all of depreciation, but I suggest that it is one way of expressing the notion of depreciation. The main point is that usage ventures are distinct from trading -- ventures: they are different kinds of ventures.

Third, there are *financing* ventures. Resources are obtained, usually in the form of monetary resources but not absolutely necessarily so, and a commitment is entered into for their subsequent return, in the same form or maybe in a different form, with or without some interim compensation for having had them made available. This type of venture covers quite a wide range, but in each case there are three fundamental events or elements that can be distinguished: the obtaining of resources, the eventual return or commitment for return, and, usually, some compensation in the meantime. For example, in an ordinary trading purchase of goods there is, first, the event of obtaining the goods and the creation of the liability to pay for them; second, there is the discharge of that liability. The third element may arise if interest is charged on the commitment; this arises particularly if there is a promissory note or bill of exchange as an intermediate step between incurring the liability and discharging it, but it may also appear as discount for prompt payment. Hence, I would distinguish between the trading venture, which commences with the acquisition of the goods, and the financing venture, which begins with the creation of the liability or commitment and ends with the discharge of that commitment. Other examples would be the issue of shares of stock in a company, and of course, straightforward bank loans and any form of

borrowing which involves repayment at the end of a certain period (or the period may be uncertain in an indeterminable venture) and the payment of interest for the use of the resources.

Fourth, another type, which I thought I could see was that of *service* ventures. A natural or acquired skill of a personal nature is made available for the benefit or enjoyment of others for a reward, the reward being financial or nonfinancial. This type of venture covers not only professional activities of various kinds -- doctors, dentists, accountants, lawyers -- but also those of tradesmen, agents, salesmen, sportsmen, entertainers, artists, domestics, and all those cases where personal services are involved. A person makes his or her skills available for a reward, and this constitutes a type of venture.

The fifth type, which I called *custodial* or *fiduciary* ventures, arises where resources are placed under the control or management of person or group of persons who, while not the beneficial owner of them, is or are responsible to another or to others for their safekeeping or disposal; the custodian is not the beneficial owner of the resources but has to account to others for them. This type covers trusts, charitable and educational foundations, receiverships and liquidations, and in the broad sense some governmental activities. At the same time some aspects of the accountability inherent in custodial ventures are present even in private enterprise corporations.

Now, in any given set of circumstances, a number of ventures of different kinds are normally being undertaken at the same time, and the character of some of the ventures may influence ventures of another kind. For example, a decision to acquire a machine or a building may be affected by past or, perhaps, prospective financing ventures. "Yes, we'd like to have this building, but where is the money to come from?" To have the building is to enter into a usage venture, but this has to be related to a financing venture. So, one of the accountant's tasks is to relate each venture to the others that are going on at the same time and to determine the distinctive characteristics of each venture from those of the others. This is not always an easy task, but it is one that accountants have to face up to and, of course, do face up to, sometimes successfully and, maybe, at other times not so successfully. However, it is necessary as a preliminary to sound decisionmaking; I beg the question here of what is sound decisionmaking, but if we can take it as given that there is such a thing as a sound decision, it is necessary as a preliminary to isolate each venture from the others, and it is this aspect of isolation which constitutes a basic feature of the recording process in accounting.

This pattern of events, ventures, and types of venture is a pattern basically related to the recording function. What is the significance of this events/venture notion? It immediately raises the question: What events are to be recognized for accounting purposes? That is, it raises the question of the selection of events to be recorded and, of course, to be subsequently reported upon.

At the simplest level or, say, at the most immediate level, the only events that are recognized are those that involve cash transactions, that is, a transfer of cash between persons. This is purely cash accounting, with which I presume we are all familiar. Next comes the recognition of debts -- debts owed and debts owing, accounts receivable and accounts payable -- and this is credit accounting. Now, both cash accounting and credit accounting are concerned with transactions, that is, events that take place between people.

After that comes the imputation of values of some sort, that is, what has come to be called accrual accounting; this has developed in regard to inventories, depreciation, and so on. When we come to this stage or level, we are getting into the area of "as if" accounting, that is, some events are recognized for purposes of accounting procedures not *because* they have occurred but *as if* they had occurred or *as if* they will occur. This is the subject of a number of balance sheet adjustments -- probably a long way behind you now in your studies.

However, if we follow this direction a bit further, we move on to what we might call prognostic accounting, recognizing future events; and to some extent we do this in budgeting, in preparing standard costs from budgeted figures, in providing forecasts of operations. To some extent we recognize events

and record them not simply because they happen, and not simply because they have happened, but because they have or because we expect them to have some relation to other events that have taken place or are expected to take place, which relationship will be significant in terms of some venture that it is desired or required to account for. This may seem involved, and, in fact, it is; but it boils down to this. We recognize and record an event not only and not simply because it has taken place, but because it has some relation to other events. And this relationship with other events constitutes the notion of the venture.

The events we are concerned with are human activities. They are not events which occur in nature; they are not natural phenomena which are operating altogether apart from human intervention. Hence, they cannot be made subject to the same kinds of experimentation or even observation as the phenomena of the natural scientist. There is a human deliberateness about them. But there is a coherence between the events comprising each venture, and this coherence is a man-made relationship. Moreover, to a great extent it is the intention to enter into a venture that constitutes the basis for the relationship which gives the coherence. In other words, if you look at the accounting records, you will see that they relate to human activities and human intentions. So that, while the event is, so to speak the atom or atomic unit for the accounting process, the more fundamental concept is that of the venture because it is the venture which gives meaning to the events. This is, if you like, a teleological interpretation of events and their coherence.

Now, it is conceivable to widen our present recognition of events; I don't suppose it is immediately likely, but it is possible to recognize more kinds of events for accounting purposes than are currently recognized. For example, it would be possible to account for commitments and obligations before they give rise to actual liabilities; warranties under which sales are frequently made are an instance. Bank overdrafts provide another; rather than, or in addition to, the overdraft position from time to time, we could account for the limit to which the bank is prepared to carry an enterprise. The potential maximum claim for damages under a lawsuit is a further instance. To do this would be, in effect, to bring some of what are now contingent liabilities into the accounting system. I feel sure that there would be no serious technical difficulty in bringing things of that sort into the accounting process. But it would comprise a difference or a broader recognition of events.

It is of interest, now, to note some of the concepts in the report of the Study Group of the American Institute of CPAs on Objectives of Financial Statements, which came out in 1973, a copy of which I got recently. It states "For purposes of this discussion .. those changes in conditions, stages or circumstances that affect the enterprise are defined as events. Events may be exchanges between parties, that is, transactions. Or events may be occurrences that affect the enterprise without being exchanges in the usual sense of the word. All business enterprises engage in related activities aimed at goals. These related activities are defined as cycles. The overriding and commanding cycle of an enterprise encompasses all the activities in its life from its inception to its dissolution. Within that life span there are other cycles and subcycles of transactions and other events. Some of these cycles are readily identifiable, others are not." (p. 27) Now this is very similar to some of the points I have been trying to make. The report then goes on: "Since the goals of an enterprise and its earning process involve the use of cash to generate the maximum amount of cash, earnings cycles should relate cash receipts and disbursements ... An earnings cycle can be classified as completed, incomplete or prospective." (pp. 27-8)

They define a completed cycle as requiring three conditions: "(1) a realized sacrifice (an actual or highly probable disbursement of cash), (2) a related realized benefit (an actual or highly probable receipt of cash), and (3) no further related substantive effort." And: "The earnings cycle is defined as incomplete (1) when a realized sacrifice or a benefit has occurred, but the related benefit or sacrifice has not been realized, (2) when both sacrifice and benefit are not realized, or (3) when the effort has not taken place. " (pp. 28-9) I must confess I am lost here when they talk about the effort not having taken place. However, they go on: "An earnings cycle may be defined as prospective whenever plans have been adopted or unilateral actions taken but neither a sacrifice nor a benefit has occurred. Examples of

prospective earnings cycles are the receipt of an order, a purchase commitment, or the adoption of next year's budget." (p. 29)

Now there are similarities between my position and that of the Study Group, but when I think of an "earnings cycle," I tend to think of something that goes round and round -- and maybe the front wheel might wobble a bit. And the report itself states that "some members of the Group believe that the notion of an earnings cycle as described herein represents a simplistic and/or impractical approach to the measurement of accounting earnings." (p. 29)

I take it that an earnings cycle is not the same as a venture because of the narrowing of the notion of an earnings cycle to cash. This basic adherence to a cash interpretation might, perhaps, equate the earnings cycle to a financing venture. But there are other kinds of ventures, surely. The earnings cycle, as a basis for the determination of objectives of financial statements, is, I feel, too narrow. Frankly, I can find only half a meaning in earnings cycles, yet this report relies to a considerable degree on the notion of cash flow generation.

Although the Study Group itself was somewhat divided on the question of earnings cycles, and, in fact, the report goes on to say: "there is no doubt that a pure earnings cycle is rare in the activities of corporate enterprises" (pp. 29-30), it does adopt it. "The Study Group members recognize these difficulties. However, the majority of the Group believes that the earnings cycle concept is useful because the classifications derived from the concept assist users in evaluating uncertainties and the earning power of the enterprise." (p. 30) Earlier, on the first page of the text of the report, they had said that "users' needs for information, however, are not known with any degree of certainty." (p. 13) This sort of admission or recognition of lack of knowledge on this point is not uncommon in accounting literature nowadays.

I am heartened in my noncomprehension of this part of the Study Group's report by comments in the recent Statement of Position on Conceptual Framework for Accounting and Reporting, issued by the Accounting Standards Division of the American Institute of CPAs. This document was prepared in response to a request by the Financial Accounting Standards Board for "views ... on the objectives of financial statements and on the qualitative characteristics of reporting set forth in the Objectives Study." (FASB Discussion Memorandum, p. 2) The Accounting Standards Division, in its position statement, says that it "does not have a good understanding of the implications of the distinction between complete and incomplete earnings cycles, and therefore it questions the emphasis ...on complete versus incomplete cycles." (P.6) Well, I am pleased to see that other people besides myself are at least a bit puzzled by this.

To sum up to this point I suggest that this recognition of things as really taking place -- events, ventures, and the several types of ventures-is what accountants are properly concerned with and constitutes a pattern of accountants are doing.

This first pattern is related primarily to selection and recording of events. But events are measured, and the second pattern is basically related to measurement, although selection also enters into it. There are four categories of "accounting" in respect of measurement. First, there is what at we might call *precision* accounting. Some things can be and are accounted for with precision. Examples are cash, accounts receivable, accounts payable, bills of exchange, quantities of inventories, quantities of investments, i.e., numbers of shares or stock units, etc. These can be and are accounted for precisely, often to the last unit.

Second, some things can be accounted for-with reasonable assurance -- within a range, though not precisely. For example, while accounts receivable are recorded precisely, their collectibility is not known with precision, but with experience we can get a basis for an acceptable approximation; hence an allowance or provision for doubtful debts is raised which is usually accurate within a range or, as the statisticians put it, within limits of tolerance. Hence this category may be termed *tolerance* (or *range*)

accounting. It applies to at least part of the monetary (but not physical) accounting for inventories, often to part of the accounting for fixed assets, and to such things as provision for pension entitlements and long-service leave and so on.

Third, beyond the first two categories, there is what I tentatively call *value* accounting, but I wish I could think of a better term for it. This category comprises things that cannot be accounted for precisely, or even within a reasonable range, but, rather, only in terms of somebody's evaluation of them at a given point in time. This applies to part of inventories (the part on hand at the end of a period which has to be valued after stocktaking), part of fixed assets, especially if they are revalued but often even if they are not, to goodwill, and so on. The main point here is that the basis of valuation is outside a range and perhaps not even related to a range. Perhaps it is not even based on my knowledge or experience in a positive sense. I prefer not to say that it is "subjective" because that would avoid the issue. I think it is essentially based on "guesstimate" and accepted on somebody's authority -- or somebody's "say-so." It might be called "authoritative" accounting, except that that term would almost certainly be misunderstood, because it is not authoritative in the sense of being definite but only in the sense of stemming from somebody's authority rather than from somebody's positive knowledge.

Outside these three categories there lies a universe of events and situations and environmental factors which cannot be accounted for in monetary or financial terms at all, which may not impinge upon the activities of an enterprise in a positive economic fashion, but which may have social implications. Examples of these things, in relation to a given enterprise, would be human resources---which have come under a little discussion by accountants in recent years -- organization, loyalty, environmental impacts and influences, etc. The expression *societal* (or socio-economic) accounting might be appropriate for this category.

Now accountants do very well in the first category -- precision accounting -- and they do pretty well in the tolerance or range category. They have some misgivings about value accounting, and they haven't yet had much to say about or much to do with the societal factors. But I envisage that it is certainly conceivable that the notion of events could be broadened to bring these environmental, societal, and human factors within the province of the accountant's work so that they become part of the accountant's headaches.

I believe that this schema applies to corporations, charitable, educational, and religious institutions, and individuals.

Those are two patterns of accountants' activities. There is a third pattern that you are all familiar with, and it relates basically to reporting. It is that reports are prepared within a time-reference -- past, present, or future. Thus, we have retrospective accounting, in which the accounting product relates to the past, and prospective accounting, which relates to the future. One could speak of present or current accounting, but I am not at all sure that there is such a thing as "the present." What is the present besides the immediate future or the immediate past? The present is instantaneous and cannot be grasped. Hence we are, fundamentally, concerned with retrospective and prospective accounting. I am sure you are familiar with retrospective accounting, for, in terms of reporting, it covers the usual income statement, balance sheet, and funds statement. And you are no doubt acquainted with prospective accounting in the form of budgeting and other projected statements, or what we may call target accounting.

In conclusion, when we consider these three patterns of activity and recognize that when the accountant is carrying out his functions these patterns are interacting and being superimposed upon each other, it is small wonder that his job nowadays is getting rather complex. I dare say it will get even more complex in the future---which is something you can all look forward to.

