

**WORKING PAPER**

**THE CASE FOR A NEW ACCOUNTING RESEARCH AGENDA IN SPAIN**

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## **Introduction**

In Spain both accounting practice and accounting research have been strongly influenced by accounting practices developed in the English speaking world. In this article we:

- 1) Summarise a seminal English paper, the 'Corporate Report', that identified the potential for accounting reports to serve a wide range of users.
- 2) Identify the ways in which English language accounting conceptual frameworks have paid lip service to a range of user needs, but in practice have excluded users other than investors and creditors.
- 3) Argue that for Spain the ideas put forward in the Corporate Report have a particular relevance, and might usefully form the basis for a new research agenda.

## **The Corporate Report - a summary**

The Corporate Report, published in the UK in July 1975, was a discussion paper produced by the UK accounting standard setting body to 're-examine the scope and aims of published financial report in the light of modern needs and conditions'. While not, strictly speaking, a comprehensive conceptual framework, it contains a number of ideas which have been influential on various subsequent conceptual framework projects. It is based on a wide ranging view of the objectives of accounting, and is an important stage in the evolution of the UK regulatory framework.

The term 'Corporate Report' is defined as 'the comprehensive package of information of all kinds which most completely describes an organisation's economic activity'. It covers not only the basic accounting statements but also a variety of narrative and descriptive statements such as the 'Chairman's Statement' and the 'results at a glance'.

## **The duty of 'accountability'**

The Report is founded upon a view that 'there is an implicit responsibility to report publicly ... incumbent on every economic entity where size or format renders it significant'. This is 'separate from and broader than the legal obligation to report'. It is seen as applying to a range of entities including limited companies, nationalised industries, public bodies, partnerships, government departments and agencies, local authorities, trade unions, trade and professional associations, pension schemes, charities, and other trusts and associations. Some suggested tests of economic significance are based on number of employees (more than 500), capital employed, and gross turnover.

The duty of accountability is seen as arising because 'the organisation commands human or material resources on such a scale that the results of its activities have significant economic implications for the community as a whole. Groups whose information needs should be recognised are identified as:

- a) The equity investor group including existing and potential shareholders and holders of convertible securities, options and warrants.
- b) The loan creditor group, whether short-term or long-term, secured or unsecured.
- c) The employee group including existing, potential, and past employees. This arises from a 'responsibility for the present and future livelihoods of employees'.
- d) The analyst-adviser group including financial analysts, journalists, economists, statisticians, researchers, trade unions, stock brokers, credit rating agencies, and other advisers.
- e) The business contact group including customers, trade creditors and suppliers and, in a different sense, competitors, business rivals, and those interested in mergers, acquisitions and takeovers.

- f) The government, including tax authorities and agencies concerned with supervising commerce, industry and local authorities.
- g) The public, including taxpayers, ratepayers, consumers, and other community and special interest groups such as political parties, consumer and environmental protection societies and regional pressure groups. This arises from 'the interdependence of all social groups' and the entity's involvement 'in the maintenance of standards of life and the creation of wealth for and on behalf of the community'.

### **Review of user needs**

Table 1 shows 15 different types of information needs summarised in the Corporate Report. These were based on an analysis of individual user group needs. A tick in a box indicates that the particular user group was identified in the Corporate Report as having the particular information need. Where an individual category of need has various aspects that differ between user groups the aspects are listed in the appropriate box. For example, equity investors need to assess whether objectives set by management, members and owners have been achieved; government are interested in the objectives set by society.

Two other user groups are discussed:

1. The information needs of analysts/advisers are similar to those of the groups they advise, but they are likely to be able to handle more detailed and complex information.
2. The general public have too wide a range of needs to be identified, but many will coincide with those of other user groups.

It will be seen that this analysis implies a range of user needs, a number of which go beyond the requirements of the investor group.

**Table 1. User Needs and the Corporate Report**

<b>Types of User Information Needs</b>	<b>Equity Investors</b>	<b>Loan Creditors</b>	<b>Employees</b>	<b>Business Contact</b>	<b>Government</b>
(a) Evaluating performance of the entity	√				
(b) Assessing effectiveness in achieving objectives set by management, members, owners or society.	√ Management, members, owners				√ Society
(c)Evaluating managerial performance, efficiency and objectives including employment, investment and profit distribution plans.	√ Investment, Profit distribution		√ Employment plans		
(d) Ascertaining the experience and background of company directors and officials including details of other directorships or official positions.	√				
(e) Assessing the economic stability and vulnerability of the reporting entity.	√				
(f) Assessing the liquidity of the entity, in its present or future requirements for additional fixed and working capital, and its ability to raise long and short-term finance.	√				
(g) Assessing the capacity of the entity to make future reallocations of its resources, for either economic or social purposes or both.	√ Economic				√ Social
(h) Estimating the future prospects of the entity, including its capacity to pay dividends, remuneration and other cash outflows and predicting future levels of investment, production and employment.	√ Dividends, investment levels	√ Cash outflows	√ Remuneration employment levels	√ Levels of production	
(i) Assessing the performance, position and prospects of individual establishments and companies within a group.		√	√	√	
(j) Evaluating the economic function and performance of the entity in relation to society and the national interest, and attributable to the entity.					√
(k) Attesting to compliance with taxation regulations, company law, contractual and other legal obligations and requirements.					√
(l) Ascertaining the nature of the entity's business and products.				√	
(m) Making economic comparisons, either for the given entity over a period of time or with other entities.	√				
(n) Estimating the value of users' own or other users' present or prospective interests in or claims on the entity.	√				
(o) Ascertaining the ownership and control of the entity.	√				

### **Justification of an expanded view**

In a review of the then legal position in the UK the discussion paper acknowledged that its view of reporting objectives was considerably wider than the implied by the law. It cited a Recommendation of the Institute of Chartered Accountants in England and Wales in issue from 1952 to 1974:

"The primary purpose of the annual accounts of the business is to present information to the proprietors, showing how their funds have been utilised and the profits derived from such use" (para. 4.1.)

Similarly a legal opinion from 1965 observed:

"... that in law the object of annual accounts is to assist shareholders in exercising their control of the company by enabling them to judge how its affairs have been conducted" (para. 4.11.)

However, the discussion paper that considered a range of legislation in the UK which included accounting disclosure provisions going beyond this narrow view. Examples included the 1971 Industrial Relations Act, the 1975 Industry Bill, the 1975 Health and Safety at Work Act. These examples together were taken to indicate an expanded view as to the accountability of entities. A survey in the UK's largest companies produced the analysis of company objectives shown in Table 2.

This was held to indicate corporate awareness of a wide range of social responsibility.

Finally, the spirit of European Community legal initiatives was seen to point in the same direction. The proposed fifth Directive on employee involvement was seen as an example of this.

**Table 2. Survey of business objectives - the results**

	<b>Number</b>	<b>%</b>
Primary objectives stated to be related to:		
profits	58	35
profits (measured in terms of shareholder return)	39	23
total related to profit	97	58
survival	16	10
service offered	31	19
other	22	13
	166	100
Responsibilities stated to be recognised towards:		
Employees	119	71
Shareholders	114	69
Customers	88	53
Community	47	28
Environment	11	7
Suppliers	10	6
The Nation	7	4
Governments	5	3
Balance of payments/exports	5	3

*Source: The Corporate Report, p. 92*

## **Objectives and characteristics**

The fundamental objectives of corporate reports are identified as being: 'To communicate economic measurements of, and information about, the resources and performance of the reporting entity useful to those having reasonable rights to such information' (para. 28.)

To achieve this, seven 'desirable characteristics' are identified - reports should be -

### 1. Relevant

This means that the report must aim to satisfy user information needs, recognised that may evolve over time.

### 2. Understandable

Here the issue of the level of sophistication of the user is addressed, and the paper calls for both all the information that a 'reasonably instructed reader can make use of' and the 'parallel presentation of the main feature for the use of the less sophisticated' (para 3.5.)

### 3. Reliable

This means that users should be able to assess the degree of confidence to be reposed in information, and the independent verification may be useful.

### 4. Complete

The information should provide 'a rounded view' of economic activities so that corporate reports will necessarily be complex documents.

### 5. Objective



This is defined as meeting 'all proper-user needs' and being 'neutral in that the proportion of the measurer should not be biased towards the interest of any one user group. This implies the need for reporting standards which are themselves neutral as between competing interests' (para. 3.8.)

## 6. Timely

Publication of the corporate report should be 'reasonably soon' after the year end so as to give 'meaningful new information' and to be 'up to date'.

## 7. Comparable

This implies consistency so as to enable comparison of the entity's results over time and with other similar entities. However, consistency should not lead to 'an unthinkingly mechanical application of generally accepted standards'.

## **Scope and content**

As we have noted, the paper saw the Corporate Report as embracing a range of statements in addition to those included in the traditional accounts. Six specific statements were recommended:

### 1. The Value Added Statement

This was seen as 'the simplest and most immediate way of putting profit into proper perspective *vis-à-vis* the whole enterprise as a collective effort by capital, management, and employees' (para. 6.7.) the report offered an example of how such a report might be presented, see Table 3.

The statement shows how the difference between sales and costs of goods bought in constitutes 'value added'. This is then seen as shared between a 'term' of employees, providers of capital, and the government. The residue is seen as reinvested in business.

**Table 3. A manufacturing company. Statement of value added**

	Year to 31 Dec 1974 £m	Preceding Year
Turnover	103.9	102.3
Bought in materials and services	67.6	72.1
Value added	£36.3	£30.1
<b>Applied the following way</b>		
To pay employees wages, pensions and fringe benefits	25.9	17.3
To pay providers of capital interest on loans	0.8	0.6
dividends to shareholders	0.9	0.9
	1.7	1.5
To pay government corporation tax payable	3.9	3.1
To provide for maintenance and expansion of assets depreciation	2.0	1.8
retained profits	2.8	6.5
	4.8	8.3
Value added	£36.3	£30.2

*Source: The Corporate Report, para.6.10.*

## 2. The Employment Report

While considering various forms of 'human asset accounting', the paper recognises problems in their application. Instead an 'employment report' is advocated, containing data, and a range of data on employment issues.

### 3. Statement of Money Exchanges with the Government

This is seen as an important factor because the range of payments to and from government are reflected in various parts of the accounts. The statement would cover:

- (a) PAYE collected and paid over.
- (b) VAT collected and paid over.
- (c) Corporation tax.
- (d) Rates.
- (e) Other sums paid to government departments such as social security.
- (f) Money receipts from government such as grants and subsidies.

### 4. Statement of Transactions in Foreign Currency

This is seen as desirable for two reasons:

- (a) There is a national interest in seeing how entities contribute to the balance of payments position.
- (b) Because of foreign currency exchange rate fluctuations, it is useful to all users.

Such a statement might cover:

- (a) UK cash receipts for direct exports.
- (b) UK cash payments for direct imports distinguishing between capital and revenue items.
- (c) Overseas borrowings remitted to or repaid from the UK.
- (d) Overseas investments or loans made from or repaid to the UK.
- (e) Dividends, interest, or similar payments received in the UK from abroad or remitted abroad from the UK.

### 5. Statement of Future Prospects

The paper discusses the problems of forecasts. It emphasises that any statement of future prospects should be a projection of past and present known facts rather than a prediction. It suggests a statement of projected future profit levels, employment levels, and investment levels, supported by a statement of the major underlying assumptions.

## 6. Statement of Corporate Objectives

This was seen as involving two elements:

- (a) A statement of general management philosophy.
- (b) Information concerning strategic targets for sales, added value, profitability, investment and finance, dividends, employment, consumer issues, environment matters, and other relevant social issues.

These six specific reports are identified in the discussion paper. Under the heading 'social accounting' the paper also identified the desirability of some form of environmental report. This was seen as impracticable at that time, but the case for research in this area was argued.

### **The Corporate Report- subsequent influence in the Anglo-saxon environment**

In 1977 the UK government published a Green paper, a consultative document put forward with a view to proposed future legislation, which incorporated many of the ideas of the Corporate Report (see Mathews and Perera, 1996). However, following the election of Margaret Thatcher's conservative government in 1979, with its strong market orientation, the proposals were not followed up.

The idea of specifying a range of users whose needs should be met has been considered in a number of conceptual frameworks developed by accounting standards setters in the English speaking world.

We consider here four examples of conceptual frameworks:

- 1) The statements of financial accounting concepts, (SFAC's), issued by the FASB between 1978 and 1985. This has been the earliest, and best resourced, conceptual framework project to come to fruition.
- 2) The IASC framework for the preparation and presentation of financial statements issued in 1989. This is important for two reasons:
  - a) It has been argued that it would make sense that we seek to define international accounting objectives before we attempt to define international accounting standards (Chetkovich, 1972, p. 106).
  - b) The IASC framework has been adopted in a number of countries. In these cases, it has sometimes been necessary to put the framework in a local context. Thus in South Africa:

"Because the framework is to be adopted without any modification, some terms requiring interpretation in the South African reporting requirement are addressed in a South African foreword" (Miller, 1990. p. 253)

- 3) The Canadian 'Conceptual framework for financial reporting' published in 1987.
- 4) The UK exposure draft, 'Statement of principles for financial reporting', published in 1995.

Although subsequently withdrawn, this statement represents the most recent UK thinking and has been influential in the formulation of UK accounting standards.

User groups are identified in our four conceptual frameworks are shown in Table 4.

**Table 4. User groups identified in conceptual frameworks**

	USA	IASC	Canada	UK
Owners	√	√	√	
Lenders	√	√	√	√
Potential Investors and Creditors	√	√	√	√
Employees	√	√	√	√
Management	√		√	
Directors	√		√	
Customers	√	√		√
Financial analysts and advisors	√			
Brokers	√			
Underwriters	√			
Stock exchanges	√			
Lawyers	√			
Economists	√			
Tax authorities	√		√	
Regulatory authorities	√	√	√	√
Legislators	√			
Financial Press	√			
Labour unions	√			
Trade associations	√			
Business researchers	√			
Teachers	√			
Students	√			
Public	√	√	√	√

Having come up with these lists, in each case more extensive than those in the Corporate Report, all four conceptual frameworks then proceed to argue that the needs of investors and creditors should be the focal points of accounting. There are some interesting variations in the reasons given. In the USA:

"the objectives in the statement are focused on information for investment and credit decisions for reasons that are largely pragmatic, not to narrow their scope. The objectives need a focus to avoid being vague or highly abstract. Investors and creditors and their advisors are the most obvious prominent external groups who use the information provided by financial reporting and who generally lack the authority to prescribe the information they want. Their decisions and their uses of information have been studied and described to a much greater extent than those of other external groups and their decisions significantly affect the allocation of resources in the economy. In addition, information provided to meet investors and creditors' needs is likely to be generally useful to members of other groups who are interested in essentially the same financial aspects of business enterprises as investors and creditors" (FASB, 1995, p. 15, originally issued in 1978).

In Canada the justification is:

- "- information needs of investors and creditors have been relatively well studied and described
- investment and credit decisions have significant effects on the allocation of Canadian resources
- information useful to investors and creditors is generally assumed to be useful to other groups" (ASC, 1987, para. 115).

For IASC:

"As investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy" (IASB, 1989, para.10).

For the UK:

"Financial statements that meet the needs of providers of risk capital to the enterprise will also meet most of the needs of other users that financial

statements will satisfy. This does not imply that other users are to be ignored: the information prepared for investors is useful as a frame for reference for other users, against which they can evaluate more specific information they may obtain in their dealings with the enterprise" (ASB, 1995, p. 36).

Thus the dominant argument in IASC and the UK, and a subsidiary argument in the US and Canada, for a focus on the user needs of investors and creditors, is that these are so comprehensive as to meet most of the needs of all users. This goes against the analysis put forward in the 'Corporate Report' and discussed above. Nobes (1985) observes:

"We should have established many years ago who financial reports were for, what information those users need, etc. This does not mean sitting around a table and guessing, as with the Corporate Report: it means an extensive empirical research programme to find out" (p. 76).

Given that such research has not taken place, the assertion in all four conceptual frameworks of a position in contradiction with the strongly reasoned case in the Corporate Report seems strange.

The point made in both the US and Canadian conceptual frameworks that more research has been undertaken on the needs of investors than other users has the merit, at least, of being biased on a sound observation. However, the logic that this should lead to placing a priority on investor needs in financial reporting implies that the priorities of academic researchers in the past should define the priorities of accounting regulators in the future. This seems something of an abdication of responsibility of the part of the accounting regulators.

To summarise, each of these conceptual frameworks:

- 1) Identifies a wide range of users to be served by accounts.
- 2) Produces arguments to focus on the particular needs of investors and creditors that do not stand up to close scrutiny.



- 3) By means of circular and insubstantial arguments affirm the traditional Anglo-Saxon focus of accounting, for investors and creditors, than other groups.

### **Relevance to Spain**

In 1911 Henry Rand Hatfield in a pioneering lecture on differences in national accounting approaches, observed that in English speaking countries accounting regulation has focused primarily on how the financial statements should be presented; by contrast in the continental European countries accounting regulation originates in prescribing the accounting records to be kept by the business. For example, in the UK in the first accounting legislation appears in 1844 in the Companies Act, prescribing the format of the balance sheet and profit and loss account, while in France the first accounting regulation appears in the commercial code of 1673, prescribing the form in which a business must keep accounting records. This tradition continued in the Napoleonic code for 1880 (see Amat and Blake, 1996).

Spain followed the French tradition of regulation bookkeeping in the commercial code of 1830. When the continental European countries have come to regulate published financial information they have tended to:

- 1) Pick up tax rules, these having been established first, and apply them as accounting rules.
- 2) Keep the style of the published accounts close to that of the double entry system. For example, in continental European systems the horizontal form presentation, listing debit balances in one side and credit balances on the other, is normal. In the Anglo-saxon tradition, whereby a story unfolds in sequence, is more common.

In developing a set of rules for published accounts Spain has been strongly influenced by the EU directives. Thus Rivera and Sociás Salvá (1995) observe:

"The real formulation of Spanish accounting principles is a phenomenon of recent vintage, forced upon Spain by the need to adopt the EU directives to the Spanish circumstances" (p. 92).

A number of aspects of the PGC of 1990 show an anglo-saxon influence:

- 1) As Labatut (1993) observed "The anglo-saxon approach of separating and considering independently accounting and tax principles is now firmly established" (p. 208). By contrast a number of EU countries, including Germany, Austria, and Sweden, have felt that continuing such a link is compatible with the EU directives.
- 2) Spain has adopted the true and fair view 'override', unlike Germany, Austria, Finland and Sweden.
- 3) The capitalisation of finance leases is prescribed in the PGC, a classic case of the anglo-saxon 'substance over form' concept.

Adoption of IASC standards similarly involves acceptance of the anglo-saxon focus on shareholder needs (see Hove, 1986). However, in Spain as in France both legislation and AECA pronouncements explicitly provide for accounts to serve a wider range of users. For example, the 1990 Spanish *Plan General de Contabilidad* states:

"The annual accounts constitute the information that must be necessarily accessible to a number of economic and social agents, interested in the present and future situation of specific societies, amongst those one can find: shareholders, creditors, employees, Public Administrations and even competitors".

AECA in its Document number 1 published by the Accounting Standards and Principles Commission identifies the users of the financial information as:

"investors, employees, consumers, the State and, in general, the society as a whole, due to the actual political, economic and social interdependence which does not allow to contemplate a fact as isolated from the system in which is inserted" (AECA, 1991, p. 15).

Furthermore, the same Document states:

"Accounting information, as a decision-making tool for the diversity of parties interested in the business activity, must respond to the needs of each of them so that they can achieve their specific objectives" (AECA, 1991, p. 22)

This different focus fits well with Spanish culture. If we consider the assessment of cultural dimensions by Hofstede (1983) the rankings for Great Britain and Spain, put of 39 countries, are:

**Table 5. Hofstede's cultural dimensions. Ranking for Great Britain and Spain**

	<b>Great Britain</b>	<b>Spain</b>
Power distance	29	19
Uncertainty avoidance	34	6
Individualism	3	20
Masculinity	8	30

Taking two of these:

- 1) The high British ranking for individualism fits well with the anglo-saxon focus on the company's reporting to owners, with no similar responsibility to these outside the business. For Spain, with a more collective approach, a focus on responsibility to other parties is more appropriate.
- 2) The 'masculine' British culture involves the assertion of separate rights for each party affected by the business. In a more 'feminine' culture a more

cooperative approach to reconciling the rights of different groups is to be expected.

The English speaking world has a long history of research in accounting issues. A recent survey shows a high level of citation of English language sources in Spanish articles in accounting, and a high level of respect for English language accounting journals on the part of Spanish academics (see Amat et al., 1998). However, our analysis of the different user groups in the English speaking world compared to Spain suggests that adoption by Spain of the accounting practices that have emerged in countries such as the UK and USA may be inappropriate. Instead, we argue that accounting in Spain based on the philosophy of wider accountability in the Corporate Report could lead to accounting reports better matched to the Spanish culture.

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