Funding the Future

Why I wrote about accounting for labour

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I published a post here yesterday that has attracted a lot of comments, not all of which I have been able to deal with as yet because many require detailed consideration that I could not do yesterday.

The first reason for this post today is, then, to apologise to those who are waiting for their comments to be published, with a response if appropriate.

The second reason for this post is to explain how yesterday's post came about, because I think that is, in itself, important if it is to be understood.

I will leave the explanation of some of the issues arising to another post, because I think that may be justified.

So, how did I come to write this post whilst on holiday on Friday, and publish it yesterday?

Accounting reform

First, I have always been interested in accounting as a form of communication. As I have said repeatedly on this blog, accounting is not a neutral or objective form of communication, and anyone who claims it is, in my opinion, denies the truth. As a human construct, accounting seeks to answer the questions its creators might wish to pose. That means that if the question changes, so must the structure of accounting.

I have played with this idea for decades. With clients, my own companies, and in my own firm, I explored ways of reporting that had little to do with a conventional accounting framework, but which did assist decision-making.

As a consequence of my concern about the environment, I thought about how accounting might address this issue long before I ever considered tax justice to be a focus for my work, partly because I considered ideas like the triple bottom line accounting that some proposed in the 1990s, I think, not to answer the need. I have now created sustainable cost accounting to address this issue, just as I created country-by-country reporting to address issues surrounding multinational corporations' tax haven abuse.

As a result, I have considered an issue that very few accountants seem aware of, which is the existence of an underlying capital maintenance concept in all accounting of any sort, and what it might mean if this were changed. I even considered this a significant issue as a third-year undergraduate student, when I became very interested in inflation accounting, which was decidedly topical at the time.

So why discuss accounting for the cost of labour now? Before discussing that, let me acknowledge that I think Prem Sikka and I discussed this issue at least 25 years ago, sitting in his slightly chaotic office in Essex. We were, I think, discussing capital maintenance in general at the time, and we both agreed that there was no reason why labour could not become the focus of financial reporting. I am not sure either of us has done very much with the idea ever since.

Imagination

So, then I come to Friday. Over the course of last week, I worked on materials for our event in Ely on 3 October (for which there are, at most, three tickets now left), where a session is dedicated to solution-focused campaigning. Let me leave what that might be aside for the moment, with a promise that I will return to it. Instead, I will note that when I discussed this with Jacqueline, she noted that the first impediment to discussing solution-focused campaigning is imagining that a better world is possible.

We then discussed the difficulty of this issue, and why this imagining process is so important.

Heisenberg

As a consequence, one of the leaps in our conversations that tend to characterise them occurred, and we discussed how Werner Heisenberg retreated to the island of Heligoland in 1925 while working on the problems then confronting quantum theory.

The detail does not matter for the purpose of this story. What does matter is that Heisenberg realised that progress required changing what the theory treated as fundamental. Instead of trying to describe the unobservable paths supposedly taken by electrons within atoms, he constructed his approach around quantities that could be observed, including the frequencies and intensities of radiation associated with transitions between atomic states.

In doing so, Heisenberg developed an unfamiliar way of manipulating arrays of quantities, which he substituted into existing formulae used to analyse those paths. Max Born then recognised that this involved matrix algebra, and he, with Heisenberg and Pascual Jordan, then developed it into what became known as matrix mechanics.

I comprehend only a little of this mathematics, at best, and it appears elegant, but that was not the point for the purpose of this story. What I immediately latched onto was something much more important. Heisenberg took a problem that existing theory struggled to explain and changed what it treated as fundamental. That change in perspective produced a radically different way of understanding the problem. The resulting work became one of the foundations of quantum mechanics and, ultimately, led, amongst much else, to Heisenberg's uncertainty principle.

The question that came to me at that point was, what would happen if we did something analogous with regard to accounting? Suppose we kept all the rules of double entry and the basic structure of accounting in the form of an income statement, a cash flow statement and a balance sheet in place, but instead of focusing upon maintaining financial capital, as is the prevailing norm within financial accounting, as laid down by the International Financial Reporting Standard Foundation in most of the world and the Financial Accounting Standards Board in the USA, we replaced the return to financial capital, which we call profit, and substituted a return to labour in its place?

It took very little time at all to sketch out what that would mean. The important point, echoing what interested me about Heisenberg, is that it is possible to take an existing problem and transform our understanding of it by changing what we choose to treat as fundamental.

Importantly, in the case of accounting, most of the framework need not change. In other words, anybody who could account at present could account using this arrangement.

In fact, the only potential technical accounting difficulty might be in deciding what the required rate of return to equity capital might be, but given there is ample evidence of average returns in stock markets on what these returns might be (and they are quite low), and that the amount of equity capital in many smaller businesses is normally insignificant in proportion to the scale of their activity, this is very far from insurmountable. After that, everything could fall into place quickly.

Accounting differently

I then wrote the piece, thinking of it as an exercise in exploring the use of imagination to suggest that other worlds are possible to replace that which I find unacceptable that we have. At a superficial level, that is exactly how the article came about. It was simply an experiment in thinking differently.

However, as some who seemed to have comprehended the idea have noted, the potential within it is revolutionary, and that may be precisely because so much within it is, in fact, entirely consistent with what we already know. The idea of treating labour not as a cost, but as the resource whose income is to be maximised as a consequence of economic activity, could massively change the way in which we organise our economy, simply by changing its accounting.

At this moment, that is the point I wish to make. If we want to create change, we must imagine that something different is possible. That is what this exercise was about. If I explore it further, as I think I now must, that will remain its initial purpose, but the point is that what I imagined is important, in itself.

Creating change

Creating a world that is focused upon the generation of returns to financial capital, when financial capital is unlimited (a claim to which I will return) and is only a human construct (a point with which I think most rational people would agree), makes no sense at all when the priority of all human activity should be meeting the needs of people, whoever they are, wherever they are, in whatever state they might find themselves, and whenever that might be.

Emphasising the return to labour does, in this situation, make a great deal more sense because it aligns the objective of the economy, as I think most people would see it, with the accounting, and so the decision-making, within that economy.

The point is that by changing an assumption, and by imagining that something else is possible, the world can be changed.

I wrote the article to make that point, but I now see it might have significance beyond that, so there will be more to come on this issue.