The Vital Role of the Accountant

Part Two of Two Parts: Some Implications When This Role Is Ignored

Through accurate accounting, vital economic decisions are made more efficiently by individual investors and firm managers on how to channel resources to their best and highest use. The need for good accounting involves far more than mere bookkeeping and arises from the fluid and vibrant nature of the modern economy. Administrable systems of accounting develop mainly when individuals and firms need to exchange information in the midst of their transactions — whether unloading boats, selling goods and services, or paying workers for their labor. Since tax accounting latches onto the accounts required for financial purposes, it should not be surprising that most taxes have as their base some portion of the financial accounts of the modern firm.

There are several implications for some ongoing debates over tax and economy policy:

(1) Switching tax systems is not going to reduce the requirement for good income accounting.

There is little doubt that the income tax system is an accounting mess. Much is due to all the special exceptions to accounting accurately for income. There is also a good case for taxing some people on the basis of their consumption rather than their income. In particular, it is hard to justify taxing more the earner who saves than the equally situated earner who does not. However, many consumption tax advocates stretch these arguments to suggest that great simplification in accounting will come simply by abandoning the income tax in favor of a consumption tax.

This view generally fails to reflect the requirement for good financial accounting. Firms still need to measure depreciation and inventory gains. They must figure out which foreign operations generate income and which do not. It is still worth knowing which subsidiaries are adding to profit, and which wage earners are being paid compensation according to the value they add to final product. If the abandonment of income tax accounting simply encourages firms to be more lazy and less informative in their financial accounting for income, then the economy becomes less productive, not more. But one thing is sure: The complexity and need for income accounting would not go away — and should not go away simply because the income tax was converted to a consumption tax.

(2) Deviations from good accounting for income represent threats to economic growth.

Consider next recent debates over items like stock options. One can reasonably debate whether or not it is possible for some firms to price options well, but a corresponding point is not debatable. Paying compensation in a form that is hard to value imposes a cost on society. The cost may be imposed on stockholders in general, who cannot figure out well how to allocate their saving according to the profitability of different firms; on stockholders of the option-providing firm, who cannot figure out how diluted their shares are becoming and, hence, delay demanding reforms when a company becomes less profitable than it may first appear; or on workers, who may be unfairly compensated by managers who cannot allocate rewards according to their productivity. Simply put, if the total amount of income and its allocation is made less certain by the offering of stock options, then there is an economic cost to both the firm and society. Such a cost can only be justified if one can prove some offsetting gain relative to all other, more accurate, forms of providing compensation.

There is plenty of fault to go around. Silly provisions in the tax code that discourage accurate accounting for income, such as the $1 million cap on the deduction for cash compensation, may have an economic cost beyond their potential tax consequences.

(3) Accountants should be trained to identify their own professionalism with accurate and transparent accounting for income — not so much for their own sake, but for ours.

I cannot emphasize enough how important accounting is to growth and the efficient functioning of the modern economy. I wonder, however, the extent to which accounting schools today call on their graduates to attain the highest level of professionalism possible.

Accountants can be trained to sell tax shelters or to hide total compensation of corporate executives from shareholders or to lobby for new tax breaks for clients. But their first and primary function as professional accountants is to serve both society and all stakeholders in any organization for which they do accounting. This is achieved only through accounting that is both accurate and transparent. Whatever the legality and profitability of the extracurricular business activities of accountants, neither they nor groups claiming to represent them should be absolved from first fulfilling their basic and most fundamental role as professionals.