

Entrepreneurial strategy v. accounting accuracy in ‘calculating’ capital and income

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Abstract Both entrepreneurs and accountants ‘calculate’ capital and income but their procedures diverge. The paper examines this divergence and the respective calculational objectives of entrepreneurs and accountants in the business enterprise. For the entrepreneur, capital and income are *ex ante* calculational judgments of prospective income gain from strategic use of the enterprise’s capital goods. But the accountant must shun entrepreneurial judgments to ‘calculate’ the contemporary net market value of enterprise’s capital goods *at a specified date*. Hence, the accountant’s calculation of income is the net contemporary increase in the market value of the enterprise’s capital goods. These accounting calculations facilitate assessment of the success of an enterprise strategy. But critics assert that accounting practice ignores the need of external investor’s for accurate information on enterprise prospects. The paper concludes with a critique of accounting regulation and explores the feasibility and means of privatizing the entrepreneurial choice of accounting techniques.

Keywords Entrepreneur · Strategy · Capital · Income · Accountant · Capital goods · Calculation

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1 Issues

Entrepreneurs and accountants confront what some may view as an apparent tension over their respective calculations of capital and income. While both

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‘calculate’ capital and income, their reckonings are sharply divergent. For the entrepreneur, the practical essence of *economic calculation* can be seen as the action of using market prices denominated in a common monetary unit to form quantitative judgments regarding the most profitable strategic exploitations of *future* market opportunities (Klein 2001, 9). Accuracy for the entrepreneur is revealed in the *ex post* profitability of chosen strategies. This view of accuracy defines the accountant’s calculational purpose within the enterprise. For the individual accountant, economic calculation refers to the use of *existing or imputed market values* of assets to assist the entrepreneur in assessing the success of currently pursued strategies (Taylor 1970, 237). Hence, accounting calculation is more focused on a type of accuracy that necessarily ignores the entrepreneur’s calculational anticipations of future enterprise capital and income. However, the paper also addresses another question: given these distinct calculational roles of the entrepreneur and the accountant, how well are external investors served by this retrospective accounting focus?

Can accuracy in the accounting of enterprise capital and income serve the needs of both entrepreneurs and external investors? External investors may well need more than an *accurate* reckoning of the net market worth of the enterprise at a particular moment of reckoning. The investor may also require accurate information on the entrepreneur’s perspectives on the prospective success of enterprise strategies and the ways in which capital and income may be affected by decisions aimed at future success.¹ Traditional accounting reports may not fully serve that need. Some analysts have alleged that with respect to reporting, current accounting practices should be more attuned to the future oriented objectives of either entrepreneurs or investors (Coase 1973, 114; Niskanen 2005b, 50). This paper examines the accountant’s quest for documentable accuracy in calculating enterprise capital and income but also explores the extent to which this quest facilitates both the entrepreneur’s *ex ante* calculation and the needs of investors monitoring or contemplating of investment in the enterprise.

Entrepreneurial strategy can be viewed as those coordinated efforts undertaken by an enterprise to ‘outdo’ competitive rivals in the quest for growth in profits (Schumpeter 1959 [1934], 81). These efforts are undertaken by an entrepreneurial enterprise with the intent of establishing profitable differences between itself and competing firms. For the individual enterprise, these undertakings frequently involve a deliberate break from the past and from the status quo within an industry (Schumpeter 1959 [1934], 81; Hayek 1949, 99–101). As such, entrepreneurial strategy may encompass choices of product, demographic-geographic markets, resources employed in production, organizational structure or even internal strategies

¹ A reviewer suggests that the discussion in the paper seems to be focused on “smaller” enterprises in which there is only a single entrepreneurial decision maker *without* managers at more subordinate levels each of whom may be acting in an entrepreneurial manner. He notes that in larger firms, such managers may be pursuing their own strategies affecting the direction of the firm. While that may be an understandable inference, such a focus is not this author’s intent. Reference to the ‘entrepreneur’ seems to suggest a major visionary personality solely determining the strategic direction of the enterprise. Such leadership can be noted in large enterprises as witnessed in the examples of Steve Jobs of Apple, Bill Gates of Microsoft Corporation, and Howard Schultz of Starbucks. Nonetheless, in large enterprises, entrepreneurial strategy may well encompass the views of several entrepreneurial personalities within the firm.

implemented to more accurately assign overhead costs to more profitably serve differentiated customers.² But regardless of the form taken, the entrepreneur's actions are always reflective of strategy to win a competitive rivalry for profits (Rumelt, et al. 1994) 9–47). In this inter-firm competition, entrepreneurial action is always experimental (Mathews 2006, 123; Yu 2005, 143).

Should accounting more adequately reflect the investment worth of an entrepreneurial strategy? Should it be? *Assume that accuracy is defined as a situation in which accounts do in fact reflect the investment worth of the enterprise.* The equivalence would mean that the capitalized income-earning worth of the firm would be documented in the accountant's calculation of what could be termed the enterprise's 'book value.' Book value would be the total the money equivalent of all assets net of liabilities as dedicated at a definite date to the conduct of a definite business unit (Mises 1998 [1949], 500). What conditions must exist for accounting information on capital and income to actually reflect prospective investment worth? In taking this question at face value, some analysts have characterized such a standard of accuracy as being implicitly grounded in stationary-state or equilibrium assumptions (Edwards and Bell 1973 [1961], 6–7). In an equilibrium world, capital and income would tend to emerge largely as objectively measurable magnitudes routinely documentable by accountants. From this perspective, there would be no need to deal with any reconciliation accountant's *ex post* measurements entrepreneur's *ex ante* calculational judgments of capital and income since the problem would not exist.

But should accuracy in accounting be gauged on a reconciliation of *ex post* and *ex ante* perspectives? In a changing, uncertain world, accounting information should provide a realistic framework for assessing the 'success or failure' of business strategies. From an *ex post perspective*, contemporary accounting actually serves this need. The *ex post* information can be critical to the entrepreneur's ability to make decisions with respect to the direction of the enterprise's activities (Edwards and Bell 1973 [1961], 66). In making chosen changes, entrepreneurs are necessarily able to gauge the success of previously envisioned profit opportunities in perhaps the planned introduction of new products or perhaps the development of new markets for existing products. Although entrepreneurs necessarily function in a speculative world in which anticipatory judgments are critical, accounting must provide entrepreneurs with the information required to assess the success of currently pursued strategic ventures. If the accountant is to complement to entrepreneur's strategic aspirations, his calculational techniques must not replicate the entrepreneur's subjective expectations of enterprise prospects.

How well does the *ex post* focus of accounting procedure address the information needs of future oriented external investors? Business strategies are essentially intangibles, the investment worth of which can also somehow be 'calculated' in a manner that is also useful to investors (Litan and Wallison 2000, 27). Critics of accounting procedure contend that accountants should be able to provide investors

² New-found accounting accuracy in allocating overhead cost must be applauded. Activity Based Costing (ABC) allows more strategically relevant allocation of overhead costs. ABC has dramatically increased the ability of enterprises to judge the true opportunity costs associated with the decisions to produce and market particular products. Thomas Taylor has characterized ABC as an important advance in economic calculation (Taylor 2000, 3–6). See also: (Kaplan and Cooper 1998, 79–107; O'Guin 1991, 5–10; Johnson and Kaplan 1987, 237–241).

with information that takes prudent account of enterprise prospects in pursuing certain entrepreneurial strategies.³ The paper examines the extent to which the accountant's calculation of capital and income should be redirected to serve this purpose.

How do accounting regulations simultaneously address issues of *ex post* accuracy and the needs of investors for *ex ante* information? Part of the answer resides in the fact that the current regulatory environment has made accountants the agents of governmental intervention and control. Governmental regulation is presumably driven by principal-agent concerns focused on the general supposition that entrepreneurial enterprises are inclined to disseminate 'inaccurate information.' But does the principal-agent concern really warrant governmental regulation? Can the choice of accounting techniques be privatized in a way that would give entrepreneurial enterprises more latitude in *supplementing* capital and income accounts with information on expectational prospects? If firms were able to choose their own accounting techniques, would private institutions provide the analysis necessary for investors to compare performance of competing enterprises? The paper also probes these latter issues.

2 Entrepreneurs' *ex ante* perspective in calculating capital and income

The concepts of capital and income take on their significant meaning within the context of entrepreneurial action and are reflective of the ends sought by entrepreneurs in implementing and pursuing business plans. The pursuit of these entrepreneurial ends is made possible by economic calculation in which transactions and assets can be denominated in monetary terms. Economic calculation has two complementary facets (Taylor 1970, 194): the first encompasses the accountants retrospective assessment of the monetary profit (income) earned as a consequence of the enterprise's currently pursued strategy. The second aspect of economic calculation is seen in the entrepreneur's *ex ante* or anticipatory judgments of the profitability of current or prospective strategies. As Thomas Taylor has observed, "the essence of entrepreneurial activity is that it is forward-looking as resources are acquired in the aim of generating money revenues sufficiently in excess of money costs" (Taylor 1970, 194). This latter entrepreneurial function is explored in this section.

2.1 The entrepreneur's anticipatory 'calculation' of capital and income

The entrepreneur is always focused on the future and is more than just a passive speculator exploiting discernable arbitrage opportunities. To a degree, he (the entrepreneur) also takes on the vital role of being a leader in initiating some form of profitable change. Joseph Schumpeter has characterized entrepreneurial behavior by noting that "The conduct [of the entrepreneur] in question is peculiar ... because it is directed toward doing something different and signifies doing something different

³ "[E]vidence comes from external investors [external to the enterprise] expressing dissatisfaction with seeing only financial reports of past performance. They want information that will help them forecast the future performance of companies in which they have invested their capital (or in which they are contemplating investing)" (Kaplan and Norton 1996, 39).

from other conduct” (Schumpeter 1959 [1934], 81).⁴ Schumpeter makes repeated reference to the ‘new combinations of the means of production’ that emerge from the entrepreneur’s innovative aspirations. As characterized by Schumpeter, entrepreneurship necessarily implies a break with the past or the status quo; by implication, the entrepreneur’s reckoning of the enterprise’s capital and income necessarily involve the exercise of judgment.

In a general sense, the entrepreneur would view *capital* as his own best subjective judgment of the net capitalized value of a business strategy employing the enterprise’s available capital goods (Mises 1998 [1949], 261). While being mindful of the enterprise’s individual capital goods at a particular moment in time, the entrepreneur, in his planning, will not necessarily focus on capital as a monetary tally of the market value of these respective capital goods. Rather, the entrepreneur will view capital as an integrated whole capable of yielding a time-stream of future net income from the pursuit of a previously chosen competitive strategy. *Income* is then the entrepreneur’s calculational anticipation of the amount by which this net capitalized value of the enterprise can be enhanced during current and future time periods. In other words, from the entrepreneur’s perspective, income is the conjectured increase in the expected net present value of the enterprise. Equivalently, income can be calculated as the anticipated time-stream of net revenue that may be withdrawn from the enterprise without diminishing its prospective net capitalized worth (Taylor 1970, 251). Viewed in this way, income and capital are obviously entrepreneurial considerations that must both be reckoned jointly. This reckoning is conditioned by the entrepreneur’s time preference, his judgment regarding the future of the market and his assessment of the success of the plans currently being pursued (Mises 1998 [1949], 482).

2.2 Income and capital maintenance as joint strategic judgments

The above discussion of capital leaves unanswered the practical questions of income and capital maintenance. What do these concepts mean in the context of entrepreneurial strategy? Income and capital maintenance are joint decisions that must be approached by the entrepreneur in a way that addresses the tradeoffs between the two. Hayek captures the essence of this tradeoff in observing the following: “The main reason is evidently that the persons [entrepreneurs] who draw an income from capital want to avoid using up unintentionally parts of the sources of income. ... Capital accounting in this sense is simply a shorthand device for preventing involuntary encroachment upon future income” (Hayek 2007 [1941], 278). In other words, a decision with respect to income is implicitly a decision with respect to capital maintenance; one necessarily has implications with respect to the other. This tradeoff means that a decision to increase the withdrawal from the enterprise implies less provision for the future and hence a possible reduction in capital.

⁴ Schumpeter, offers his own examples that suggest the scope of this type of behavior “(1) ...introduction of new goods ..., (2) ...new methods of production...(3) ...opening of a new market,(4)...conquest of a new source of supply of raw materials or half-manufactured goods. (5) ... carrying out of a new organization of any industry” (Schumpeter 1959 [1934], 66).

The rate of time preference comes into play in such entrepreneurial decisions. In placing time preference in the context of the evenly rotating economy (i.e. steady state), Ludwig von Mises notes:

The praxeological distinction between capital and income is a category of thought based on a different valuation of want-satisfaction in various periods of the future. In the imaginary construction of the evenly rotating economy it is implied that the whole income but not more than the income is consumed and that therefore the capital remains unchanged. An equilibrium is reached in the allocation of goods for want-satisfaction in different periods of the future. ... As soon as a change in the data occurs, the individuals are faced anew with the necessity of choosing both between various modes of want-satisfaction in the same period and between want-satisfaction in different periods (Mises 1998 [1949], 482).

Mises observes that in the ‘evenly rotating economy,’ income and capital would seem to have some sort of objective existence. But in such a world, the active planning function of the entrepreneurial enterprise never emerges because it does not exist. However, in the real world of uncertainty and change, income and capital maintenance are essentially subjective choices or judgments that must be made within an integrated but speculative strategy. Neither income nor capital maintenance can emerge as constants or as a *fait accompli* in entrepreneurial deliberations. Such strategic decisions are made against a changing and uncertain market backdrop. Part of this milieu may include the uncertainty faced by the entrepreneur in introducing a new product employing a new technology, entry into an existing industry or a new geographic market. What is income in this context? What is capital maintenance? In confronting these questions under realistic market circumstances, the entrepreneur’s decisions are strictly matters of economic speculation. As Mises asserts,

the employment of the gross proceeds, their allotment to the maintenance of capital, consumption, and the accumulation of new capital is always the outcome of purposive [deliberative] action on the part of the entrepreneurs and capitalists. It is not ‘automatic’; it is by necessity the result of deliberate action. And it can be frustrated if the computation on which it is based was vitiated by negligence, error, or misjudgment of future conditions (Mises 1998 [1949], 512).

In the entrepreneurial decisions, depreciation must address the role of particular capital goods as complementary elements within the overall entrepreneurial strategy (Mathews 2006, 89–91; Kaplan and Norton 2001, 67). Hence, depreciation must be judged within the context of the way in which all its complementary capital goods are employed in a strategy in the pursuit of future income. While one recognizes that ‘depreciation’ may be reflected in physical wear and tear of a particular capital good, the critical issue is its complementary effectiveness in attaining the enterprise’s desired level of current and future income. As capital is a net reckoning of the investment worth of the complementarities sought within the entrepreneurial strategy, depreciation is a judgment of the diminished efficacy of capital-good combinations in achieving goals sought by the enterprise.

While depreciation is always judged within the context of the respective complementarities between the respective capital goods, a maintenance decision is never focused necessarily on ‘wear and tear’ sustained by particular capital goods as such. Each maintenance decision is ultimately about the most profitable complementarity thought to be possible within a chosen combination of capital goods employed in pursuing an entrepreneurial plan (Lachmann 1986, 63; Hayek 1941, 276–280; Mises 1998 [1949], 512). The entrepreneurial maintenance of private capital under conditions afforded by anticipatory economic calculation has the following *implicitly interrelated but critically distinct features*:

- entrepreneurs make judgments of the anticipated, yet uncertain, monetary tradeoffs between current investments in maintenance and the desired future income return;
- the entrepreneurial enterprise integrates plans for the maintenance of *all capital goods* into a comprehensive business plan focused on the maintenance of desired time profile of future income (Hayek 2007 [1941], 277);
- physical deterioration of particular capital goods is addressed *only* to the extent it is judged to ‘depreciate’ future monetary income yielded by *all the capital goods as an integrated, complementary combination*;
- the business entrepreneur makes a rational ranking of maintenance priorities rendering judgments of the extent to which total revenue productivity of *all the capital goods as a complementary combination is affected*;
- *maintenance plans for particular capital goods are unique to the individual entrepreneurial enterprise*, reflecting the enterprise’s own market expectations and the particular complementarities sought in its chosen capital-good combinations; and
- since maintenance undertaken is tied to a monetary income, the enterprise links its maintenance investments to the demand for its products as expressed by its customers (Lachmann 1986, 67–71).

Obsolescence of capital goods raises another troublesome aspect of capital maintenance that can pose challenges for both entrepreneurs and accountants. Hayek notes that “... problems which are of importance arise out of the fact that at any moment much of the capital equipment in existence of society exists in a form which cannot or will not be reproduced” (Hayek 2007 [1941], 250–251). In this vein, Hayek highlighted the entrepreneurial challenges created by ‘economic’ obsolescence of capital goods. Some capital goods will not be reproduced but must be replaced because they are ‘obsolete’ in the context of enterprise strategy. Hayek observes:

[E]ntrepreneurs are quite as likely to foresee that the capital good will become useless long before it is physically worn out or decayed as they are to know that its useful life will be terminated by its physical breakdown. ... this means in particular that the investment in capital goods liable to obsolescence must be so restricted that the prices of their services, or their gross return, will include an amortization quota sufficient to replace them ultimately by new capital goods which will yield a future income that is equal in value to the net return of the old ones which are being consumed. ... In order that the instrument of only transitory usefulness may appear equally attractive to that in the instrument of more lasting usefulness, it will be necessary for the former, while it remains in

use, to produce gross returns sufficiently large to allow for full replacement of its original income-earning power (Hayek 2007 [1941], 281–282).⁵

Obsolescence is a routine fact of life for certain industries that are driven by rapidly improving technologies or appeals to fashions and changing tastes. For example, industries that are reliant on the services of computer technologies face the realities of obsolescence of computer equipment consequent to improvements in both software and hardware. Replacement of equipment is necessary even though the computer equipment currently employed is quite functional. Also, automobile manufacturers are obligated to stay abreast of changing tastes in body styles meaning that much of the machinery designed to manufacture current body styles is obsolete long before physical wear would prompt replacement. Hence, depreciation and obsolescence do not and cannot emerge as objectively measurable phenomena. Rather, they are matters of judgment with which the entrepreneur must deal in his strategic efforts to maintain income and capital. Obsolescence itself, as reckoned within an entrepreneurial strategy, must reflect an understanding of changing consumer tastes and the rates at which competing enterprises are adopting new technologies and manufacturing techniques. Both conventional depreciation and obsolescence create amortization challenges that are not only highly subjective but unique to the individual enterprise (Lachmann 1986, 67). But how do the services of accountants complement and serve these entrepreneurial decisions? Can accounting techniques be made to incorporate these strategic judgments into the accounts of the enterprise? Should accounting techniques be made to incorporate these *ex ante* judgments?

3 The standard for the accountant's focus in achieving accuracy

The entrepreneurial enterprise provides the venue and the focus for the application of the accountant's efforts to achieve accuracy. But by what criterion should accounting accuracy be assessed? One view is that accounting information can be adjudged accurate if reports reflect the prospective investment worth of the enterprise. But this standard of accuracy would be *implicitly reliant on an unchanging steady-state*. Another more relevant and more realistic criterion would be one in which accounting for capital and income can be viewed as accurate if it relies on contemporary prices or market values of capital goods. The following discussion examines the implications of these approaches to accounting accuracy.

3.1 Accounting accuracy as reporting enterprise prospective worth

Assume that accounting accuracy is assessed on the basis of the degree to which enterprise prospective investment worth is reflected in accounting reports of capital and income. Under what circumstances could accounting accuracy meet this standard? Certainly this standard of accuracy could be met if the underlying analytical assumptions of mainstream neoclassical economics were to hold. By

⁵ On this general subject, see also Hayek (1941, 276–280).

ignoring or deemphasizing uncertainty and economic change, the accountant is presumably able to achieve desired objectivity. Neoclassical economics presents a static equilibrium paradigm that seems to ignore the more realistic and pervasive aspects of entrepreneurial action and market change. Were persistent equilibrium a reality, it would assure that the concepts of capital and income were not 'clouded' by subjective conjectures and aspirations of entrepreneurs. There would be no future that ever involved sustained sequences of economic changes. Taken literally, this assumption would mean that what are commonly labeled 'economic variables' could be treated as though they were objective data.

Are these features overstatements of the requisite steady-state equilibrium assumptions required to achieve this standard of strict accounting accuracy? The writers Edgar Edwards and Philip Bell seem to think so. In their highly regarded book, *The Theory and Measurement of Business Income*, Edwards and Bell have outlined the extreme economic assumptions that would need to hold if accounting reports were to accurately reflect the prospective investment worth of the enterprise:

... we shall take as our first task the demonstration that traditional accounting procedures are predicated implicitly on the utter absence of change. ... When this complex of practices is ... laid bare, it is clear that present day accounting would yield accurate and truthful results only under very special circumstances. ... The basic purposes of accounting are to measure for the business unit its efforts (costs), its accomplishments (revenues), its success (the difference between revenues and costs) over time, and its position (what it owns and owes) at any moment in time. ... The functional assumptions of accounting outlined here are the description of a set of conditions under which these statements ... would be complete, truthful and unambiguous. ... if prices, quantities and qualities of both factors and products were unchanging over time, i.e. if there were a stable price level, stable individual prices, and perfect certainty about the future. ... Only then can the allocation of costs and revenues among, past, present and future periods be certain. ... This is necessary if the operations of a continuing firm are to be *measured accurately* for fiscal periods (Edwards and Bell 1973 [1961], 6–9; emphasis added).

Presumptively, if these conditions were to hold, the accountant's calculation of capital and income would be exactly equal to that of the businessman's *ex ante* perspective.⁶ Edwards and Bell offer these observations only to highlight the unreality of assuming that accounting accuracy can be assessed on the basis of the extent to which reports faithfully reflect enterprise prospects. In a relatively static, unchanging world, congruence between the respective reckonings of the businessman and the accountant would ostensibly be expected. Depreciation and capital maintenance would scarcely be matters of judgment. The accountant's task would take on the character of simple bookkeeping. The certainty implied in these assumptions would seem to largely preclude or ignore consideration of *ex ante* profit as may be sought in an entrepreneurial strategy dealing with market uncertainty. The ostensible motive of Edwards and Bell in providing this description is to suggest that

⁶ Reference is made to the 'businessman' rather than the 'entrepreneur' since the latter would not actually exist in the conditions specified by Edwards and Bell.

the legitimate focus of accounting accuracy is not prospective in nature. Hence, a conventional standard of accounting accuracy generally eschews estimation, forecasting or projection as noted in the *Rules of Professional Conduct* of the American Institute of Certified public Accountants:

A member shall not permit his name to be used in conjunction with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that the member vouches for the accuracy of the forecast.⁷

Nonetheless, the issue of accounting for enterprise prospects is not a totally closed issue. As Thomas Taylor notes:

It is important to distinguish between the proposal that the determination of actual income and wealth be based upon expectations and the idea that expected income be reported as supplementary information to the statements of income and financial position which are to be predicated upon historical data. The latter view does not advocate the use of discounted cash flows in the basic [conventional accounting] statements (Taylor 1970, 196).⁸

The desirability of supplementing conventional accounting income and balance sheet statements hinges on the extent to which such information would be useful to external investors. This latter issue is addressed at greater length in a latter section of this paper.

3.2 Accuracy in capital accounting as market valuation of capital goods

In principle, the accountant's efforts should yield requisite feedback and insight in the entrepreneur's assessment of earlier actions with respect to capital maintenance and the anticipated level of prospective income (Taylor 1970, 203). Since income, capital and capital maintenance involve speculative choices on the part of the entrepreneur, the accountant's reports must provide benchmarks of success with respect to the entrepreneur's previously chosen strategy. Hence, a second approach to assessing accuracy would focus on the contemporary market valuation of the enterprise's capital goods. Capital goods are those depreciable assets that have been marshaled by the enterprise to implement a business plan. Ludwig von Mises clarifies the accounting linkage between capital goods, capital and money.

There is no such thing as an abstract or ideal capital that exists apart from concrete capital goods ... capital is always embodied in definite capital goods and is affected by everything that happens with regard to them. The value of an amount of capital is a derivative of the [market] value of the capital goods in which it is embodied. The *money equivalent* of an amount of capital is the sum of the money equivalents of the aggregate of capital goods to which one refers

⁷ As quoted in Schattke 1962, 674.

⁸ Taylor references two papers supportive of projection as supplements to accounting reports: (Cooper, et al. 1968, 640–648; Schattke 1962, 670–676). More recent guidelines and admonitions concerning supplementary accounting projections have been provided; see Boni 2000, 1–4 in a download of an *Inc* article: www.inc.com/magazine/2000401/18118.html.

in speaking of capital in the abstract. ... Capital is always in the form of definite capital goods (Mises 1998 [1949], 262: emphasis added).⁹

In his comments on the nature of an enterprise's capital accounting, Mises reiterates his point with respect to the requirement that capital goods be expressed in terms of a money equivalent:

Capital is the sum of the *money equivalent* of all assets minus the sum of the *money equivalent* of all liabilities as dedicated at a definite date to the conduct of the operations of a definite business unit. It does not matter in what these assets [capital goods] may consist, whether they are pieces of land, buildings, equipment, tools, goods of any kind and order, claims, receivables, cash, or whatever (Mises 1998 [1949], 500: emphasis added).

But how is the 'money equivalent' of capital goods to be determined? As noted above, for the accounting profession as whole, the answer to this question is far from a settled issue. Much of the disagreement within the ranks of accountants seems to revolve around the avoidance of procedures reliant of speculative judgments in the valuation of assets and the reckoning of enterprise income. For example, procedures involving the capitalization of expected cash flow would be avoided because they would preclude the accountant's ability to 'accurately measure.'¹⁰ In the name of objectivity and accuracy, some accountants rely on unexpired 'historical cost' (initial money outlay minus accumulated depreciation charges) as one means of expressing capital goods as a 'sum of the money equivalent (Ijiri 1971, 1–14). This approach has the appeal of affording a type of accuracy and presumably, for this reason, remains an approach favored by some accountants (Sterling 1970, 17).¹¹ Other accountants find themselves defending liquidation or 'exit' valuation of the enterprise's capital goods (Chambers 1971, 74–96). This latter approach yields quantifiable data in situations in which the enterprise's capital goods are readily marketable but becomes more challenging in those circumstances in which capital goods are specific to the enterprise (i.e., asset specificity) (Solomons 1971, 110: Vatter 1971, 120).

In his analysis of capital accounting, Ludwig von Mises argues for the use of current market information in the appraisal of enterprise's capital goods. Mises is apparently referring to market prices of capital goods in using the term "money equivalent." With respect to the asset side of the balance sheet, Mises suggests that "[c]apital accounting *starts with the market prices* of capital goods available for further production, the sum of which it [capital accounting] calls capital" (Mises 1998 [1949], 488:emphasis added). Under this interpretation, the accountant can achieve accuracy under conditions that would seem to allow capital goods

⁹ While the entrepreneur is able to look at the aggregate of the enterprise's capital goods as a complementary grouping employable in a quest for future income, the accountant is by necessity forced to establish the money equivalent of each of the enterprise's individual capital goods to arrive at the aggregate total for capital accounting for the enterprise.

¹⁰ In personal communication, Randall Holcombe has noted: "when investment is involved, the resources that the firm purchases don't get immediately transformed into cash, so the entrepreneur wants a measure of the *potential* future cash flow tied up in the firm's capital, which is where accounting comes in."

¹¹ For a critical perspective, see Solomons (1991, 156).

to be valued on the basis of observable or at least imputable market information.¹² The entrepreneur's *ex ante* judgment of the enterprise's income-earning potential is necessarily written out of the accounting picture. Hence, even in acknowledging entrepreneurial planning, one can no longer assume equivalence between the accountant's calculation of net market value of the enterprise's capital goods and the entrepreneur's forward-looking assessment of capital.

Measurement of enterprise income logically follows from the accountant's attempt to establish the money equivalent of the capital goods committed to the enterprises on a particular date by employing price information revealed in or imputed from conditions in the current market. From the accountant's perspective, income is the measurable or imputable total increase in the *current net market value* of capital goods devoted to the enterprise during the particular accounting period during which performance of the enterprise is being evaluated (Taylor 1970, 227).

3.3 Accounting accuracy in calculating capital maintenance and income

Income and depreciation are closely linked in the calculations of the accountant. Where as the entrepreneur is principally concerned with protecting the future income and views depreciation as the diminished capacity of the enterprise's combined capital goods to generate that prospective income, the accountant must take a more present-oriented, piece-meal approach. Depreciation can be viewed in alternative ways ostensibly satisfactory in the accountant's quest for objectivity and accuracy. However, some of these alternatives may be only marginally relevant to the entrepreneur's method of reckoning. Straight-line depreciation would be one such example. In any case, as Mises asserts, accounting judgments must be based on calculations grounded in capital accounting:

The capital concept is operative as far as men in their actions let themselves be guided by capital accounting. If the entrepreneur has employed factors of production in such a way that the money equivalent of the products at least equals the money equivalent of the factors expended, he is in a position to *replace* the capital goods expended by new capital goods the money equivalent of which equals the money equivalent of those expended (Mises 1998 [1949], 512: emphasis added).

In a critical sense, the ostensibly contrasting pursuits of entrepreneurs and accountants should be complementary. From the accountant's perspective, capital refers to the net market value of all the capital goods dedicated at a particular moment in time to profit seeking strategy of a particular enterprise. Whereas the entrepreneur imputes a comprehensive investment worth of the complementary capital goods based on anticipated profitability of a strategy, the accountant must arrive at a reckoning of these goods based on externally established market valuation. The importance of this latter reckoning resides in the 'inferred opportunity

¹² A reviewer has noted the reality that data on the current value of the enterprise's capital goods may not be available. Indeed, this issue may be one of the most challenging issues facing business accountants. In his extended discussion of the importance of employing the current market valuation, Thomas Taylor acknowledges that in some instances, the accountant may need to rely on approximation and estimation (Taylor 1970, 296).

costs' of these goods in alternative market uses by other enterprises.¹³ This totality of these market valuations of the enterprise's capital goods yields the accountant's calculation of the enterprise's capital at a particular moment in time. The accountant's aggregation of these market values provides the entrepreneurial enterprise with a benchmark or feedback with which to assess the profitability of the currently-pursued business strategy.

Obviously the accountant's calculational reckoning of the market value of enterprise's capital provides that framework for determining whether the enterprise's capital has or has not been maintained. But capital maintenance does not necessarily hinge on any stipulation that the goods previously employed in the enterprise's production process need to be replaced by identical or even similar capital goods. Physical maintenance of the inventory or stock of capital goods employed by the enterprise does not necessarily constitute maintenance of enterprise capital (Lemke 1982, 319).

Hence, in a changing and uncertain market environment, successful maintenance of capital for the accountant would imply that the imputed or observed monetarily-assessed market value of the enterprise's capital goods remains unchanged during the current accounting period. At the beginning and at the end of the accounting period, the money value (market value) of the capital goods employed by an enterprise is a *reflection* of the competitive opportunity cost of these goods in alternative employments elsewhere in the economy¹⁴; Also at the beginning of the accounting period, the employment of the capital goods reflects the entrepreneur's expectation that the minimum monetary contribution expected to be made by these goods is at least equal to their market value. Taking account of depreciation as may be reflected in any diminished market valuation of each *individual* capital good, the accountant determines that the enterprise's capital is maintained if the market value of the enterprise's *combined* capital goods at the end of the accounting period remains unchanged over that measured by the accountant at the beginning of the accounting period – irrespective of any change in the composition or mix of these capital goods.

Hence, the money equivalent of capital goods employed by the enterprise may be viewed as *both* a market reflection of the opportunity cost of these goods in alternative employments and, at the same time, an imputation of their worth within the context of its currently pursued strategy. However, this dual reflection should not be seen as implying that this value represents any abstract capital fund capable of yielding its own a level of economic productivity (Taylor 1970, 248; Hayek 1941,

¹³ Thomas Taylor helps to clarify the relationship between opportunity cost and the accountant's reckonings: “[t]he concept of money equivalent cannot be separated from the idea of market transactions and market prices which express the *relative importance of various goods and services*” (Taylor 197, 228: emphasis added). But in considering ‘opportunity cost,’ a clear distinction must be drawn between the calculational perspectives of the entrepreneur and the accountant. From the viewpoint of the entrepreneur, as a decision maker weighing alternative courses of action, the inferred opportunity cost’ revealed in the accountant’s reckoning of the money equivalent of the enterprise’s capital goods, may be only one element in the entrepreneur’s *ex ante*, essentially subjective judgment of opportunity cost (Buchanan 1969, 38–50). However, Buchanan goes on to acknowledge that in a tight neoclassical equilibrium, marginal opportunity costs would be the same for all decision makers (Buchanan 1969, 85). But, as noted above, in such an equilibrium, entrepreneurial enterprises would not exist.

¹⁴ Describing the market value of capital goods as a *reflection* of the opportunity cost of these goods is not intended to suggest that these ‘values’ are necessarily precisely *equal* to their opportunity cost. See the preceding footnote.

276–280). Any conventionally imputed productivity of the enterprise’s ‘capital’ is entirely contingent on the entrepreneur having chosen and pursued a strategy during the current time period that serves consumer needs in a manner that yields the revenue sufficient to maintain capital value as reckoned by the accountant.

What constitutes enterprise *income* in the context of efforts to maintain enterprise capital? From the accountant’s perspective, the enterprise has earned income if the net market value of the enterprise’s capital goods at the end of the accounting period *exceeds* the value of the enterprise’s capital goods measured by the accountant at the beginning of the accounting period. Recall that in Mises’ discussion of capital goods he included money itself. Monetary balances would be included in the accountant’s tabulation of the ‘money equivalent’ of the enterprise’s capital goods. While these monetary balances held by the enterprise may reflect liquidation of certain capital goods during the current accounting period, in the main, these money balances will reflect revenues earned by the enterprise in its current strategic aspirations—that is, revenue yielded by the sale of goods and services that have been the enterprise’s strategic focus during the current accounting period. If this amount of money together with the money equivalent of the enterprise’s other capital goods are just sufficient to maintain its capital, no income has been earned, when viewed in the calculation of the accountant. But any amount in excess would be a legitimate accounting calculation of income.¹⁵ This net reckoning would take account of price changes of capital goods and depreciation that other capital goods may have sustained during the current accounting period. This calculation of depreciation by the accountant would not be ‘measured’ in physical terms but rather as decrements in the money equivalent of each capital good employed in the production process. The market information employed by the accountant to measure capital and income must be current to assure that the accountant’s calculations do not diverge from current market valuation. Use of historical information would be minimized by the accountant implying that contemporary imputation would be an integral part of accountant’s responsibility.

4 Issues of regulation, information adequacy and private choice of procedure

The preceding discussion establishes that the entrepreneurial enterprise is best served by accounting procedure centered on contemporary market appraisals of the enterprise’s capital goods. Such accounting procedure would be employed internally by any well-managed entrepreneurial enterprise and would be implemented without any coercive pressure to comply with an externally imposed regulatory standard.¹⁶

¹⁵ Thomas Taylor observes that “in defining income as the incremental change in capital between two points in time, there is no exclusion from this determination of income of any change in capital except for those changes arising from withdrawals or additional investments” Taylor 1970, 238). This approach to income definition avoids any traditional but misleading accounting distinctions between ‘realized’ and ‘unrealized,’ ‘separated’ or ‘un-separated’ income. Taylor goes on to note: “Income occurs despite the fact that this increment of capital is ploughed back into productive use within the enterprise. In determining income, it makes no difference in what form the enhancement of capital takes” (Taylor 1970, 240).

¹⁶ A reviewer notes that “for the strategic decision-maker, i.e., the ‘entrepreneur’ (management!), it should be pointed out that internal/managerial accounting serves this purpose without any governmental regulations except perhaps special accounting rules dealing with governmental contracts involving, for example, cost-plus agreements.”

Some assert that accountant's reports should also play an indispensable role in the decisions of investors (Litan and Wallison 2000, 48). A question remains over the extent to which external investors can be better served by augmenting reports with additional information on the enterprise's future prospects.¹⁷ Can responsible standards of accounting accuracy be maintained in the context of augmented reports that serve these broader reporting needs? Critics have claimed that in attempting to serve the needs of investors, regulated accounting procedure has failed to adapt to the modern realities of entrepreneurial business world. In general, regulation is thought to be required in situations in which the private incentives are not serving the 'legitimate welfare interests of the public.' In accounting, the presumptive 'market failure' is the possibility that enterprises may be induced to provide inaccurate information to investors. But is governmental regulation really the best means by which to deal with issues bearing on accuracy? What is the real information failure, if it exists? What kinds of information do investors really need? Can a coherent case be made for privatizing the choice of accounting techniques? What would be the nature of accounting practice if business enterprises were able to choose their own approach to capital and income accounting? Would private institutions emerge to better serve the legitimate information needs of both the enterprise and its investors?

4.1 Suspected market failure and the presumed need for government regulation

The presumptive market failure in accounting information is of the 'principal-agent' (Pearce. 1992, 344) sort in which agents, as represented by entrepreneurial enterprises, are thought to have the ability and inclination to provide 'inaccurate or misleading information' to principals as represented by investors. Stated another way, the presumed situation can be characterized as one in which there is an asymmetric availability of information to the managers of the enterprise and investors. This asymmetry is thought to work to the disadvantage of investors; hence, investors need to be 'protected.' Viewed as a presumptive 'market-failure problem', the accuracy of capital and income accounts is thought to require government oversight and the regulatory imposition of strict accounting standards. Recent accounting scandals seem to have reinforced this urge to regulate.

In the United States, accounting for business enterprises is heavily regulated by several governmental bodies, most of which are arguably focused on assuring some type of accuracy in business accounts. For publicly traded enterprises, the principal organs of oversight and regulation are the Security Exchange Commission (SEC) supported by the standard-setting functions of the Financial Accounting Standards Board (FASB). But this regulatory oversight has come under severe criticism. For example, accounting practice, as it has been molded through regulatory pressure, evinces an almost studied ignorance of the business strategy and its implication for the reporting of capital and income. Moreover, the accounting regulations imposed by the SEC and other governmental bodies have been known for some time to have a stifling effect on innovation in accounting practice and has had a clearly

¹⁷ To some extent supplemental information is currently made available in "Executive Summary and Discussion" sections of annual reports.

retrogressive influence on the profession (Edwards and Bell 1973 [1961], 282–283; Solomons 1986, 194–19; Kaplan and Norton 2001, 374; Johnson and Kaplan 1987, 198). But even in the narrower context of its existing regulatory mandate, the SEC has a track record of failure. For example, the SEC did not detect the problems associated with Enron or the Bernard Madoff Ponzi scheme. William Niskanen of the Cato Institute has leveled his own blistering condemnation of the regulatory power of the SEC and the FASB.

The interests of neither corporate nor investors are best served by assigning the authority to set accounting standards to the FASB, the SEC or the Congress. [The FASB], as a private monopoly, has proved incapable of developing accounting standards that are concise, *nonarbitrary* and timely. The SEC has no special expertise or interest to understand whether the FASB has proposed a better accounting standard, other than a response to political pressure. Congress has no expertise to recognize better accounting standards, and it is generally biased in favor of rules that create or protect private rents [i.e., income in excess of what would established competitively]. This leads me to conclude that the authority to develop and set accounting standards should not be assigned to any private or public monopoly (Niskanen 2005b, 52: emphasis added).¹⁸

Niskanen emphasizes the need for competition between accounting techniques. The existence of competition between accounting ‘rules’ would necessarily imply a process that allows a choice of accounting procedures. In stipulating that accounting procedure should be ‘nonarbitrary,’ he seems to be suggesting an approach to privatization that would largely preclude business enterprises from actually having complete freedom of choice in approaches to capital and income accounting. Even in light of what has occurred in terms of financial scandals, can a compelling case be made for allowing entrepreneurial enterprises such freedom of choice? If choice of accounting techniques can be privatized, what options are feasible?

4.2 Means of privatizing choice of accounting techniques

Niskanen’s means of introducing competition and hence choice would necessarily involve a complete abandonment of the current regulatory process and presumably the repeal of some of the largely misguided provisions of the Corporate Responsibility Act (Sarbanes-Oxley) passed by the Congress and signed by the President in 2002.¹⁹ In the

¹⁸ In using the phrase ‘rules that create or protect private rents,’ Niskanen is apparently referring to the tendency of the U.S. Congress to pass statutes favoring certain groups by protecting or enhancing the levels of income that may be in excess of the ‘competitively-earned’ income necessary to draw members of the group into certain employments. This charge has been raised in connection with executive salaries (Reynolds 2005b, 245–282).

¹⁹ The Corporate Responsibility Act is seen as misguided because its provisions were premised on the idea that the major bankruptcies such as Enron and WorldCom were the result of accounting malpractice. In fact, the accounting practices that were employed by these companies were attempts to conceal the consequences of bad business decisions (Reynolds 2005a, 18–19; Niskanen 2005a, 6). But Reynolds goes on to note that there are several negative consequences of the Sarbanes Oxley; among these are: (1) compliance costs are significantly increased; (2) enterprises are dissuaded from going public and having their stocks listed on an exchange; (3) incentives to undertake risky investment strategies are reduced; and (4) difficulties in recruiting board members are increased (Reynolds 2005a, 33–34).

Niskanen proposal, competition between accounting techniques would be achieved through choices made by several or more privately owned and controlled stock exchanges. Niskanen conjectures that “[t]he one institution that has the greatest potential to capture the third-party benefits of good accounting rules, I suggest, is the stock exchange on which the corporation is listed” (Niskanen 2005b, 52). Under Niskanen’s plan, competing stock exchanges would be autonomous and would decide upon the accounting rules for the companies listing their stock on a particular exchange. As he sees his plan being deployed, the accounting rules would perhaps start as variations of Generally Accepted Accounting Principles (GAAP) but would not be bound by strict adherence to those principles. His supposition is that companies choosing to have their stock listed on a particular exchange will adopt and comply with the exchanges accounting rules if the benefits of the particular accounting standard exceed the costs involved in employing the standard. He assumes that investors desiring ‘non-arbitrary, transparent and timely’ financial reports would pay more for the stock of companies listed on the particular exchange (Niskanen 2005b, 52–53). The respective exchanges would compete in trying to ‘most efficiently’ address the preferences and needs of both the enterprises listed and the investors.

The Niskanen plan has features that make it an attractive option. First, the plan is premised on the abandonment of the current regulatory apparatus; the SEC would no longer play a regulatory role. Second, ease of comparability would be assured for investors attempting to assess difference in the performance of the respective enterprises listed on the particular exchange. Niskanen acknowledges that the standards employed by competing exchanges could diverge perhaps significantly over time. Of course, one consequence of such divergence could mean that investors comparing stocks listed on different exchanges could encounter additional costs in making comparisons of company performance. A third feature of Niskanen’s proposal is that companies would have at least some voice and preference in determining the accounting standards with which they chose to comply.

4.3 Accounting standards may not fully satisfy investors need for information

The extent to which Niskanen’s system should be adopted hinges in major part of on the degree to which the accounting systems that ultimately evolve are able to address the capital and income reckonings of the accountants and the information needs of investors. Put more bluntly, the concern is that enterprises would still be forced to comply with an accounting standard that may not fully provide needed information concerning the expected investment prospects of an enterprise’s chosen entrepreneurial strategies. Investors are not necessarily best served by accounting systems focused solely on accuracy without also addressing the implication of chosen strategies on the reckoning of capital and income.

Another approach to privatizing the choice of accounting procedures is much more attuned to the realities of economic change in a truly free market economy. Richard Leftwich, Professor of Accounting at the University of Chicago, has dared

to propose that enterprises be empowered to actually choose their own accounting procedures.

It is not necessarily in the interest of stockholders to constrain managers to use the same accounting rules for external reporting regardless of the circumstances facing the firm even if those uniform rules reduce stockholders' decision-making costs. Management's choice of accounting methods can affect a firm's cash flows because the firm's reported accounting numbers influence its negotiations with government regulatory bodies, wage and price control agencies, unions, civil rights groups, politicians, environmentalists, and consumer groups. If measurement rules are flexible, managers can choose rules which maximize the value of the firm, given the effect of those rules on negotiations with various parties (Leftwich 1980, 207).

Accountants have been sharply critical of Leftwich's free-market perspective with respect to firms choosing their own accounting rules. David Solomons is scornful of the Leftwich proposal:

Few ... have been as outspoken in their defense of management's right to confuse and mislead their critics—and inevitably, of course, their stock holders, since they must be fed the same information. *And all of this in the name of maximizing the value of the firm.* It is no wonder that well informed critics ... raise questions about the credibility of accounting (Solomons 1986, 188: emphasis added).

It is noteworthy that an eminent professor of accounting such as Solomons would be outraged by the desire to employ accounting techniques that offer the enterprise greater opportunities maximize the value of the enterprise's capital. Similar sentiments are also advanced by Edwards and Bell with respect to firms using accounting rules to enhance the value of the enterprise: "The origin of some proposed changes, for example, can be traced to the corporate income tax and the fact that, if adopted ... the size of the tax paid by corporations would be reduced. The stoutness of the working accountant and his auditor colleague in fighting changes proposed for this reason is commendable" (Edwards and Bell 1973 [1961], 282). But in the context of an argued need to supplement information, the logic of Leftwich's argument cannot be ignored; he reasons:

If there is a system of accounting that provides better information, firms will produce that information in a well functioning private market, provided that they can capture enough of the benefits to offset the costs. If superior information is not produced, either firms are ignoring profit opportunities, or the critics have incorrectly evaluated the cost-benefit tradeoff (Leftwich 1980, 205). ... *There are no objective criteria for choosing among the set of available accounting techniques.* Even if the particular techniques were selected by independent observers, the numbers produced would not be independent of the observer. Different accountants of unimpeachable integrity, presented with same facts could report different accounting numbers (Leftwich 1980, 207: emphasis added).

As an allowance for the provision of supplemental information Leftwich's recommendation would not constitute a full-scale adoption of subjective judgment in the reports of accountants. Nonetheless, of course a principal concern centers on the issue of comparability and transparency of information made available to investors.²⁰ Some would resist the Leftwich alternative on the grounds that it would increase the costs incurred by investors in trying to compare the performance of different firms. But a strong counter argument can be advanced even by those who emphasize the importance of comparability:

...third-party analysts would provide some sort of company-by-company reconciliation for investors as a way of demonstrating their value as analysts. ... These reconciliations will be limited if companies ... do not disclose as much information as they would if required to prepare any reconciliation. Nonetheless, market pressure might cause companies to provide a similar level of information for reconciliation purposes as is the case under a mandatory system. Alternatively, approximate reconciliations performed by third parties might be more than adequate for investors to make informed decisions, including decisions to forbear from investing because available information is inadequate (Benston et al. 2003, 11).²¹

But the underlying fallacy in the criticism of entrepreneurial choice is that the presumed market failure is somehow corrected by mandating historically-based accuracy through enforced compliance with currently existing accounting rules. Is this type of accuracy really the answer?

Criticism of enterprise choice of accounting techniques is, in part, premised on the notion that investors are hapless ignoramuses and managers have unmitigated venal incentives to provide misleading or fraudulent information. Is one to conclude that competition for investment dollars plays no role in inducing enterprises to provide realistically accurate information regarding the firm's future prospects? At some point, investor will be induced to invest elsewhere if an enterprise establishes a track record of providing *seemingly* inadequate information with respect to prospective capital and income. The adjective 'seemingly' is employed in light of the fact that all entrepreneurial strategy is inherently experimental which means that success is never certain. In fact the probability of success or failure is of a 'case nature' meaning that there is no historical statistical experience that would permit a precise, a priori estimate of success (Mises 1998 [1949], 110–113). Does failure of an entrepreneurial strategy mean that previously provided accounting information was presumptively inaccurate? Certainly not. Nonetheless, such a presumption seems to be the driving force behind the urge to impose rigid accounting standards on entrepreneurial enterprises. Moreover, investors do not need to be treated as

²⁰ A reviewer has raised the question of how much information should be revealed to outside investors. He notes the presumption that more information is thought to be favored over less but he seems expresses skepticism that such a decision should be left to the companies. But another reviewer has noted that entrepreneurial strategy may necessitate some competitive secrecy in terms of its activities, technologies or new products. These concerns may highlight the need to avoid making some information available to the investing public.

²¹ See also: Taylor (2002, 9). Third parties would include fund managers, financial advisors, and economic forecasters, as noted by a reviewer.

though they are oblivious to the uncertainties surrounding the success of entrepreneurial strategies. Each investment made by an investor is in itself an entrepreneurial undertaking. Perhaps the last word in addressing these issues has been advanced by Thomas Taylor:

But the bottom line is that all the talent and expertise in the private sector are the source of sound accounting standards and auditing procedures. ... Actually, what we need is less government intervention and a more competitive marketplace in which investors come to understand that investors themselves are the final authority in judging the soundness of a company's books. We need to let firms provide audits to whom they would like, however they would like, and whenever they would like. The market can sort out the best companies and standards (Taylor 2002, 9).

5 Conclusions

The paper has explored the stark difference in the ways in which entrepreneurs and accountants 'calculate' capital and income. Does this difference suggest that there should be some reconciliation between these contrasting approaches to calculation of capital and income? *Clearly the answer is no.* These divergent approaches suggest that accuracy must be approached from distinctly different perspectives for the accountant to complement the strategic aspirations of the entrepreneur: his calculational procedures cannot simply replicate the entrepreneur's best conjectures of enterprise prospects. But shouldn't accounting reports with respect to enterprise capital and income also be aimed at satisfying the information needs of external investor? In a narrow and strict sense, *the answer is no.* However, separate releases of supplemental information by the enterprise are entirely appropriate and can help address the need of external investors.

Do existing laws and regulatory institutions play a useful role in protecting investors and serving their information needs? *Again, the answer appears to be no.* The repeal of existing laws would help not only investors but also entrepreneurial enterprises and accountants. Governmental regulation implemented to address principal-agent concerns has failed to provide investors and entrepreneurial enterprises with accounting information that addresses major intangibles critical to responsible assessment of enterprise prospects.

Should efforts be made to allow market institutions evolve accounting procedures that would best serve the need of all affected parties? *Here, the answer is yes.* Having competing stock exchanges specify accounting standards seems to be a viable alternative although it would still leave enterprises in a position of having to comply with externally imposed standards. Also, one cannot dismiss an approach in which each entrepreneurial enterprise would choose its own accounting technique; the demand for accounting comparability would be met by the services of private firms serving the needs of investors. While companies would always be criminally liable for outright fraud, market discipline in itself would always punish the abuse of accounting choice through loss of investor interest in the offending enterprise.