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THE ACCOUNTING ASPECTS OF CORPORATE SOCIAL RESPONSIBILITY

A Dissertation

Submitted to the Graduate Faculty of the Louisiana State University and Agricultural and Mechanical College in partial fulfillment of the requirements for the degree of Doctor of Philosophy in The Department of Accounting

by

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ABSTRACT

After an impressive discussion of the problems relating to the accounting and reporting aspects of corporate social activities, the 1972 Committee on Environmental Effects of Organization Behavior of the American Accounting Association recommended that the accountants should not attempt to measure and report the total social costs of damage to the environment resulting from organizational behavior. The Committee cited several reasons to support the above recommendation.

The major proposal of this study runs counter to the Committee's recommendation. It proposes that immediate attention from the accounting profession is necessary to account for and report on the social activities of the corporate enterprise in its traditional reporting model. This proposal is based on the conclusion of the primary objective of this study that (1) corporate resources committed to social activities can be measured in monetary terms based on the input cost methodology proposed in this study; (2) the resulting costs of these social programs can be accounted for and reported on based on existing generally accepted accounting principles; (3) the cost allocation problem between the regular operation of the company and undertaking these social activities is not new for the accountants. However, experimentation is
needed to arrive at the most reasonable cost allocation methodology to insure the reliability of the accounting figures; and (4) the attest function of the accountant is not jeopardized or rendered unnecessarily difficult. However, the accountant has to rely, to a greater extent, on the opinions of experts from other disciplines. Of course, this reliance is not new in the accounting profession. Actuarial considerations in pension plans are accepted by the accountant with heavy reliance on the opinion of the independent actuaries. The opinion of the legal counsel as to the status and/or existence of contingent liabilities is likewise relied upon by the accountants.

For internal reporting, the study concludes that both quantitative and qualitative data may be provided for internal decision makers. However, the requirements for qualitative data may not be critical at this point. Companies which responded to the pervasive social problems are more concerned with how much in dollar terms, and from an input cost standpoint, such social responsiveness is costing the company.

The study also concludes that given the state of the art, the concept of social auditing may not be operational in the foreseeable future. Nevertheless, if such concept is rendered operational the social audit report might be considered as a special report to supplement the traditional financial statement models of the accountant. Consequently, the primary media for reporting the social activities of the corporation are still the traditional reporting models of the accounting profession.
As secondary objectives of the study, the concept of corporate social responsibility and the related issues of the quality of life have been discussed. Likewise, the economic aspects of the concept was explored. As a result, an operational definition of corporate social responsibility as well as a definition of the quality of life has been formulated. Social and economic rationale for corporate social responsibility has been outlined for both the corporation and its managers.

Finally, the social responsibility of the accounting profession has been discussed. A definition of the accountant's social responsibility has been offered, and a social profile for both the accountant and the accounting profession has been formulated. To make the accounting profession responsive to the needs of society, a foundation for a contemporary accounting theory has been presented.
PART I

THE CORPORATE ENVIRONMENT

The pressure for expanded responsibility and involvement that is being felt by the accounting profession is but a small part of the total social change that pervades our society today. Much of this clamor for change has been directed towards a major social institution -- the corporation.

In our free enterprise system, the corporation becomes a part of the everyday life of all segments of society where enormous wealth, power, and intelligence are concentrated. From society's point of view, the corporation has been irresponsible in using these resources to such an extent that the very existence of society itself is endangered. Consequently, society demands from the corporation a certain degree of responsibility in utilizing these vast resources.

Part I of this study discusses the major social issues relating to the pervasive corporate environment. A key point underscored in this discussion is the rapid change that has transpired and is still transpiring in our society today. Specifically, Chapter I outlines the objectives, scope and the methodology of this study. Chapter II deals with the issues relating to the quality of life, and the concept of corporate social responsibility as well as the economic aspect of such concept. The issues concerning the social responsibility of the accounting profession is discussed in Chapter III.
INTRODUCTION

The current discussion of corporate social responsibility and the related issues relating to the quality of life create complex problems for the accounting profession. These problems consist of two basic but critical areas: (1) the philosophical framework of the role of the accounting profession which extends to its societal obligations, and (2) the accounting consideration of these social issues to enable the profession to provide financial data which are useful to all segments of society.

The first problem consists of a conceptual definition of the social role of the accounting profession. In this era where the basic preoccupation of society is for the improvement of the quality of life, the role played by every social institution is under scrutiny. Society demands a concerted effort from every segment, whether as individuals or as groups, to help in solving these social problems. For the accounting profession, this demand for involvement has a far-reaching effect. It involves a reexamination and a reevaluation of the existing accounting philosophy to serve as the foundation of accounting objectives, principles, standards, practices, and procedures and rules consistent with the needs of society.

The second problem is addressed to the traditional responsi-
bility of accounting in providing useful economic data. In recent years, industry has been steadily committing a considerable amount of its resources for social causes, but these outlays have not received adequate recognition in the accountant's reporting model, commensurate with their significance. Currently, the corporate community is under intense pressure from various groups to assume leadership in dealing with these social issues; institutional investors, which account for a substantial portion of investments today, are urged to include in their investment criteria the social performance of corporations.

But where will these institutional investors (and, for that matter, all other financial statement users), obtain this information considering the fact that their traditional source -- published corporate financial statements -- does not provide these data? Or to address the question directly to the accountants: Is the accounting profession willing to provide these data via its financial reporting model?

**Statement of the Problem**

The accounting problem which this study will be dealing with is neatly woven into a much larger concept which has engulfed every fiber of American business -- corporate social responsibility. Any attempt to solving such an accounting problem without addressing the relevant issues of this concept will not only result in a narrow understanding of the problem but will also result in a myopic view of the larger problems resulting from the corporate social responsibility concept as well as its future implications for society, for the philosophy and direction of business in this country, and for the solution to the accounting problem itself.
The main accounting problem - The question as to whether or not the accounting profession is willing to provide the information regarding the social performance of an enterprise in its reporting model is actually an enormous problem for the accountants to answer. There are two main reasons for this: (1) the accounting aspects of social performance involve quantitative and qualitative measurements, and the latter, based on existing generally accepted accounting principles, are not objectively verifiable, and therefore are beyond the current scope of accounting and the accountant's reporting model; and (2) one of the critical issues in the current discussion on social performance has centered on the cost-benefit measurement of social programs.

The cost aspect of social programs may not be too difficult to handle. However, their benefit side poses an extremely difficult problem which is currently beyond the expertise of accountants. Not surprisingly, the accounting profession, even at the risk of diminishing its stature as an information provider, opted to maintain a low profile. At the forefront are economists, statisticians, psychologists, social scientists, and other disciplines which are attempting to solve this problem.

A closer look at the cost-benefit problem, however may lead to conclude that it is overwhelming only on the surface. A scientific analysis of its nature and its realities may provide a basis for attacking such problem. Viewed from the context of financial data users, cost alone, rather than cost-benefit data, may be relevant to the decision models of external users. And since this cost is, for the most part, reasonably quantifiable and objectively verifiable, it is within the framework of existing generally accepted accounting principles and
therefore could be reported to external users.

Cost-benefit data, on the other hand, are relevant to the decision models of internal users because their concern is the efficient and effective allocation of scarce company resources. Moreover, benefits are quantitatively and qualitatively measurable which fit into the decision models of internal users.

The primary objective of this inquiry is to measure in dollar terms the corporate resources committed to pursuing social goals, to investigate the accounting treatment of the costs of these resources in accordance with generally accepted accounting principles, and to offer a framework for reporting such costs in the traditional reporting models of the accountant.

Related accounting and other problem areas - Dealing with the broad issues of corporate social responsibility is like opening a Pandora's box, for the concept embraces the related social issues of the quality of life, the role of the various institutions in enhancing societal goals, its economic impact on the business community, and above all, the rationale for involvement in social issues. At the center of these issues is the modern corporation which is looked upon to assume a major role in solving current social problems, especially environmental pollution, and in general, improving the quality of human life.

The question now is: Can the modern corporation involve in social issues without sacrificing its economic mission? Is there a rationale or perhaps a novel corporate philosophy, which is good enough to sustain any deviation from the profit motive? Finally, if social involvement is defensible, to what extent shall the modern corporation
pursue this social responsibility concept?

A secondary objective of this study is to formulate a social and economic rationale for corporate involvement in social issues, and to investigate the related issues of the quality of life as well as the economic aspects of corporate social responsibility.

Portrayed prominently with the concept of corporate social responsibility is the social responsibility of accountants and the accounting profession. This is understandable. Since accounting is the language of business, the accounting profession is deeply and intimately involved in the conduct of the now-besieged corporation; therefore, it is expected by society to exercise influence over corporate affairs. One way of influencing the activities of corporations relate to changing a passive corporate behavior towards a higher degree of sensitivity to social problems. A change in this behavior would require a different role for the accounting profession as a communicator of information between the corporate system and the total society. This means that the accountant's communication models have to be expanded, if not changed altogether. This means also that the current generally accepted accounting principles have to be disturbed to give way to non-financial measures which are beyond quantification and objective verification. In short, measuring up to this new expectation of society also means accepting new problems for the profession. But for every challenge, there is a corresponding opportunity for service and the ramification of a good service is enhanced stature and financial reward.

A secondary objective of this study is to investigate the
issues relating to the social responsibilities of the accountant, and to formulate justifications for the accounting profession's acceptance of a broadened responsibility in the light of the rising expectations of society from social institutions in promoting social goals.

A broadened responsibility has to be reconciled and rationalized in terms of existing accounting theory to establish a frame of reference for useful generalizations, establishment of standards, guidance in practical affairs as well as the establishment of a framework for improving the resulting uses of accounting data. This reconciliation and rationalization has to be done in this study (or at least identify a direction for such undertaking) to pave the way for the development of a cohesive set of accounting philosophy, consistent with the needs and requirements of the expanded function and responsibility of the accounting profession.

A secondary objective of this study is to provide a framework for establishing a contemporary accounting theory which is responsive to the dynamic demands of its environment.

Approach to Solving the Problem

As implied in the preceding section, the expanded responsibility of accounting stems from the enlarged expectations of society for the conduct of the modern corporation, which include not only economic but also social performance. Therefore, a systems approach is appro-
private to understand the relationships among the interacting systems and subsystems that contributed to the problems under study. The system contemplated in this study composed of three main subsystems, namely, society, the corporation and the accounting profession, is depicted in Figure 1.

Four areas of research shall be undertaken in this study. The first area is concerned with the interaction between society and the modern corporation which is embodied in the current issues of corporate social responsibility and the quality of life. The research includes a survey of current literature on the subject for the purpose of formulating a rationale -- economic and societal -- for corporate involvement in this concept.

The second area of research consists of the interaction between accounting on the one hand, and the modern corporation and society on the other. This interaction gives rise to the current issues on the social responsibility of the accounting profession. The research will survey the current literature in this area with the specific goal of formulating a rationale for the profession's acceptance of an expanded responsibility. Consequently, an attempt shall be made to develop a framework for establishing a contemporary accounting theory which is consistent with the needs, desires and operations of society today.

The third area deals with the measurement of the costs of the resources utilized in pursuing social goals, and the accounting and reporting problems of these costs. The analysis includes a discussion of the proposed costing methodology, the identification, definition and classification of the costs of social programs, a discussion of
Figure I

A Systems Approach to Analyzing the Accounting Profession's Expanded Responsibility
the accounting treatment of such costs in accordance with generally accepted accounting principles, a review of the current reporting practices in the annual reports concerning this matter, and the reporting of these costs in the traditional reporting model of the accountant. The research encompasses a survey of the significant literature on the subject as well as a review of the annual reports of selected companies.

To give substance to the revisions made to the traditional reporting model of the accountant and to test the operational aspect of the proposed methodology for costing the resources committed to social involvement, the last area of research is to ascertain the feasibility of these proposals relative to an actual company environment through the cooperation of a large multinational oil company.

Limitations of the Study

Except for a limited few, the basic and the most significant characteristic of outlays for these social programs is that the direct benefit of money spent is intended for certain groups which are either clearly or fuzzily identified, or not identified at all. The benefit to the company is indirect; possibly in terms of good image and an assurance to the conscience of corporate management that it is doing its part to enhance social goals. Measuring the cost and the benefit derived from these social programs can be useful to decision-makers. But a strict cost-benefit measurement is extremely difficult, and therefore, beyond the scope of this study.

Accordingly, cost measurement in this study shall be limited to input costs, that is, the dollar outlays incurred in a particular
social program. For instance, in the case of an air pollution equipment, these input costs may consist of the cost of the equipment, the cost of operating the facilities, and occasionally, certain research costs associated with the project.

The benefit shall be measured in terms of the objective or goal accomplished. For example, if the goal of the pollution equipment is to reduce the carbon monoxide emission by 50 percent, the benefit shall be evaluated on this basis.

Gathering these input costs on the firm's social programs can be very useful for planning purposes. Corporations currently engaged in promoting social goals are asking how much these activities are costing them. Knowing these costs may provide an impetus for more action, or, perhaps, retrenchment. Nevertheless, this input cost and goal accomplishment (benefit) methodology was empirically tested with the cooperation of a large oil company. However, the peculiarities of that company may have biased the results. Therefore, more empirical research is needed to test the operational content of this methodology.

The attempt to gather these input costs resulted in the formulation of a simple data gathering system within the participating company. Due to certain time constraints, the overall effectiveness of this information system has not been ascertained. An encouraging optimism was, however, expressed by the company personnel who served as the writer's counterpart in this project. The system will be in full operation for the calendar year 1974.

The methodology, because of certain time constraints within the company, has not been tested for all the social programs of the
subject company. However, representative projects were selected from the firm's air pollution control activities and from its program of helping minority businesses.

Finally, external users, either as investors, consumers, regulator or just as a part of the general public, are equally in need of the above data. But the accountant's reporting models do not report them. Consequently, the emphasis of this inquiry is to report these data to external users.

**Definition of Terms**

For the purpose of this study (as mentioned in the preceding section), cost refers to input costs, that is, expenditures incurred by the company in pursuing a social program. Benefit refers to the established goals accomplished by a particular social project.

The terms social programs, social projects, social activities, social involvement, social issues, social concerns, socially-relevant projects (or programs), or social performance shall be used interchangeably to mean those activities which are generally of current public concern and are undertaken by the company for the benefit of its employees, customers, and the public at large as the result of either conscience, social pressure or force of law, having no direct benefit to the enterprise.

Definitions for such terms as corporate social responsibility, the social responsibility of the accounting profession or social audits shall be defined as the discussion progresses.
Organization of the Study

This study is organized as follows: Chapter II discusses the pervasive corporate environment as it relates to the issue of the quality of life and the concept of corporate social responsibility as well as its economic implication. Chapter III covers the social responsibility of the accounting profession.

The proposed framework for a contemporary accounting theory is presented in Chapter IV while Chapter V covers the problems concerning the accounting and reporting considerations of social programs.

Chapter VI contains the results of the feasibility study conducted in cooperation with a large multinational oil company. Finally, the summary, conclusions, and recommendations for future research are presented in Chapter VII.
CHAPTER II

THE PERVERSIVE SOCIAL ISSUES

For a modern businessman, the purpose of business, particularly the corporate enterprise, is to satisfy the material needs of society at a profit. Over the years, business has been successful in accomplishing this purpose. However, in recent years society's expectation from business goes beyond the satisfaction of its material needs. Society is now asking the businessman to be involved in promoting social goals in order to improve the quality of its life.

To be discussed in this chapter are the key issues relating to the quality of life and the concept of corporate social responsibility. Likewise, the economic implication of the latter concept will be explored.

I. QUALITY OF LIFE: A SOCIAL CRISIS

The economic power of the American society is founded upon its unsurpassed productive capabilities. This is primarily the result of its extreme emphasis on the production of goods and services. Understandably, the American society rewards and applauds those who can deliver goods not only in terms of personal prominence but also in financial terms.

However, in recent years, this emphasis on production has gone
through a critical reexamination and reorientation. The reason is that the American society realizes that massive production of goods and services has certain undesirable consequences. These undesirable effects are manifested principally by the deteriorating air and water pollution problems of the country. The seriousness of these problems are reflected in the current concern for the quality of life.

This portion of the study is designed to provide an understanding of the term "quality of life" as well as to provide an insight into the important issues related to it.

Meaning of Quality of Life

The term "quality of life" is a fashionable and a fascinating concept in intellectual circles, and is expected to be an important issue in the seventies. But the concept has no precise definition, and no attempt has been made either to define or discuss this concept in meaningful terms.1

---

1The literature on the quality of life appears to be plentiful. However, as far as it could be ascertained, only a few deal directly with the subject. In fact, no definition of the term has been found. Generally, writings that touch on the subject are found in the literature on welfare economics. In addition to the writings of such prolific writers as A. C. Pigou, Kenneth Boulding, Robert Heibroner, E. J. Mishan, Nicholas Georgescu-Roegen, John K. Galbraith, Emery Castle, Ralph Turvey and others, articles which devote certain amount of discussion on the subject are found in such publications as The American Economic Review, Land Economics, Journal of Farm Economics, Quarterly Journal of Economics, Journal of Political Economics, and a few other publications. Two significant publications which deal with the quality of life are Towards A Social Report, (U. S. Department of Health and Welfare), and Toward Balanced Growth: Quantity with Quality, (National Goals Research Staff). Fortune magazine has devoted a special issue on pollution and the quality of life in its February 1970 issue. Recently, the Midwest Research Institute published an index rating and statistics on the quality of life in the United States. See Ben-Chieh Liu, The
The fact that the "quality of life" is nebulous and confusing is articulated in the 1970 State of the Union Message of President Richard Nixon:

In the next 10 years, we shall increase our wealth by 50 percent. The profound question is -- does this mean we will be 50 percent richer in a real sense, 50 percent better off, 50 percent happier? 2

Despite this difficulty in defining the concept, any discussion concerning the quality of life is generally addressed to such social issues of general import as environmental pollution and degradation, education, public services, urban renewal, poverty, unemployment, equal opportunity, housing, crime, and the like. Other issues of a more personal nature includes one's views on his marital life, his family environment, his income, his job, his immediate environment, and other similar areas of concern.

Based on the above social issues, it could be inferred that the quality of life is actually one's or a group's perception of reality of his or society's well-being. Therefore, the quality of life could be defined as the state of affairs (or one's sense of well-being) of society as perceived by a person or groups of persons. The key point that should be observed in this definition is that a person's sense of

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well-being depends on his perception of reality, which may be faulty. A fear of crime on the streets, for instance, may have no relation to the actual happenings. Thus, the question as to how quality of life can be measured may always be a problem.

Quality of Life: A Social Crisis

To state that the American society has already solved its quantitative problem is not at all an exaggeration. But while the concern for quantity has subsided, the problem of quality has started. The reason for this change in attitude is that the American society has come to realize that the quality of life cannot be measured in quantitative terms. As President Nixon stressed in his message to Congress in 1970, wealth is not synonymous with happiness, and economic growth is just a means of attaining specific goals.

The magnitude of the problem appears to be on the critical level. A British writer, after his tour of the United States in 1969, wrote his impressions in this manner:

The United States in this last third of the twentieth century is the place where man's long economic problem is ending, but where his social problems still gape. On any rational view, the enormous fact of that approach to economic consummation should rivet all attention. It is almost certainly the most momentous news story so far in the history of the world. But people in the United States are at present wracked by the stretching to snap-


5U. S. National Goals Research Staff, op. cit., p. 27.
ping point of too many of their temporary social tensions, so that this society which represents man's greatest secular achievement sometimes seems to be on the edge of a national nervous breakdown.\(^6\)

A subsequent opinion survey seems to validate this impression. When a majority of Americans look at their own lives, the survey contends, they are reasonably content with their present conditions, and express confidence that things will improve for them. But beyond their own lives, the outlook is not encouraging. As the survey points out:

> When they look out of the window beyond their neighborhood, they are less pleased with what they see. They worry about rotting cities, lurking muggers, rising prices, and polluted water. They are skeptical about the government's ability to be of much help.\(^7\)

Actually, the concern for the quality of life could be traced to two main factors. First, there is a widespread question as to the ability of the environment to absorb all the waste generated by every human activity. In addition, while the earth's resources are still of vast supply, they are nevertheless, finite, and there is an unquestionable need to set up priorities for their use. Boulding underscored dramatically these areas of concern when he discussed the future of what he calls the "spaceship earth." He contends that "tomorrow is not only very close, but in many respects it is already here." He adds:

> The shadow of the future spaceship, indeed, is already falling over our spendthrift merriment. Oddly enough, it


seems to be in pollution rather than in exhaustion that the problem is first becoming salient.  

Second, there are shifts in attitude in every fiber of society, and there is a strong tendency to stress "quality over mere quantity; the individual over the organization; equity and justice over economic efficiency; pluralism and diversity over uniformity and centralism; participation over authority; and personal convictions over dogma."  

Evidently, a similar situation was found in a survey sponsored by the Potomac Associates, Inc. The study concludes that the American people "seems to be searching for a new political, social, and economic philosophy, one that will infuse them with new purpose."

Quality of Life in Perspective

Before one can discuss the perspective of the quality of life, two points must be explored and understood: (1) the American commitment to quantity is the backbone of this society, and (2) a methodology for measuring the quality of life is imprecise and misleading.

Commitment to Quantity - Society's commitment to quantity occupies a significant portion of its history. The lives of the founding fathers have always been characterized by a constant struggle to

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9Day, op. cit.

better their existing possessions and well-being. As a result, economic growth has been considered a virtue which provides a potent force for this nation's enormous economic achievement. Macrae summarizes this point succinctly:

Americans are still twitching under the murmur of recent ancestral voices down these two or three bare generations. These voices have been telling them that in the land free of European residues of feudalism, all can and should drive forward to get things done -- and should then hope in turn to see their children automatically surpass them in education, occupation and prosperity.11

Economic growth has always been the overshadowing component of this nation's goals; and the overwhelming role of profits have become indispensable. The late President John F. Kennedy put it in this manner:

In a free enterprise system, there can be no prosperity without profits. We want a growing economy and there can be no growth without investment that is inspired and financed by profits.12

But in recent years, the concept of maximum economic growth has become an anachronism. Galbraith paved the way for this thought. He argued that the efforts of the affluent society have always been directed towards the production of material goods, and since this goal has already been attained, efforts should be directed and channeled towards the enjoyment of the human life.13 Although counter arguments

11 Macrae, op. cit., p. 25.


have been presented to rebut Professor Galbraith's thesis, it is apparent that the nation listened to him. The seventies marked a commitment by the current administration towards a balanced growth, that is, quantity with quality. Intellectuals began to question growth, per se. In their book, The Limits of Growth, Professor Dennis S. Meadows and his associates at The Massachusetts Institute of Technology provided a classic evidence against growth. They conclude that with a population growth of about 2 percent, and an output expansion of about 7 percent, the earth's natural resources will run out by mid-21st century, and ultimately, the human race will perish. This reexamination of growth has affected the outlook of the most avid proponent of demand creation and consumption -- the marketing discipline. Marketing scholars are now concerned with responsibility in distribution as well as responsibility in the consumption of goods and services.

Finally, the energy crisis has provided the most overwhelming evidence of society's attitude towards profits. As Time observed:

...it was obvious that the oilmen were in for a rough time. They found themselves under fire for accomplish-


ing what has long been considered the goal of the U. S. economic system: making a high profit.18

Measuring the Quality of Life

As mentioned earlier, the quality of life is a function of ones sense of well-being or the well-being of society. This involves social values, and people differ in this respect. A family, for example, that has been residing in an apartment building for many years may consider moving into a house with a lawn as an improvement in the quality of its life. On the other hand, one would not want to mow the lawn may consider such a decision as undesirable. This divergence in values makes the evaluation of the well-being of society not only difficult but also complex in terms of setting up priorities.

At the present time, the most popular measure of the economic well-being of the nation is the gross national product (GNP). It measures output, but it does not measure satisfaction. The GNP is sensitive to the production of goods and services, but it does not show whether or not the people are healthier or happier. Thus, there is an extreme need to develop a methodology for measuring and reporting the satisfaction of society.

One possible way to measure quality of life is to conduct a carefully designed opinion survey upon which to develop an index of satisfaction, health, happiness, etc., of the nation could be developed.

The main advantage of such an index is that it is sensitive to attitudi-
 nal shifts of society. In recent years, numerous polls and surveys
 have come up with similar results as far as the ranking of social
 issues are concerned. Topping the list are social issues as crime,
 pollution, drug addiction, health care and similar social concerns.

Summary

This section has dealt with the issues of the so-called quali-
ty of life. Apart from the nebulous and confusing aspect of the concept,
 there has been no meaningful attempt to define it. Consequently, this
 study defines quality of life as the state of affairs (or one's sense
 of well-being) of society as perceived by a person or groups of persons.
 Underscored in this definition is the idea that a person's sense of
 well-being depends on his perception of reality, which may be faulty.

Likewise, emphasized in this discussion is the attitudinal
 shift that is occurring in our society today. This is manifested by a
 change of concern from quantity to quality, a trend which is directly
 opposed to the historical commitment to quantity of this nation.

The inexistence of a precise measurement of the well-being of
 society has created serious problems for policy makers. Consequently,
 this study proposes the use of opinion surveys upon which an index of
 satisfaction, health, happiness, well-being, etc., of the nation can be
 developed. These surveys have the advantage of being sensitive to
 shifts in society's attitudes.

The next section will discuss the relevant issues of the con-
 cept of corporate social responsibility.
II. SOCIAL RESPONSIBILITY: A CORPORATE DILEMMA

The preceding discussion has dealt with the pervasive issues of the quality of life which force the reappraisal of the basic classical economic models. Included in this reexamination is a scrutiny of the roles played by the various institutions in our society today. As a result, a catchall concept — corporate social responsibility — surfaced. ¹⁹

This section will discuss the relevant issues of corporate social responsibility as they affect the existing corporate environment. The discussion will begin by examining the role of the corporation in a modern society. Consequently, the conflicting views of the concept

¹⁹The literature on the role of the corporation in a modern society and on the issues of corporate social responsibility has increased tremendously in the last ten years or so. In addition to the books written by such authors as John K. Galbraith, Peter Drucker, Philip Blumberg, George Steiner, Joseph McGuire and many others, excellent articles on the subject can be found in the issues of such publications as California Management Review, The Conference Board Record, Business and Society Review, Harvard Business Review, MSU Business Topics, Business Horizons, and others. Recently, the National Affiliation of Concerned Business Students (NACBS) published a bibliography on the subject. Likewise, Bank of America is in the process of compiling a similar bibliography. A number of dissertations were written either specifically or devoting, to some extent, a discussion on the matter. The most significant of this writing was authored by Van Cook McGraw, "An Analysis of the Social Responsibilities of Business Managers," an unpublished dissertation, Louisiana State University, 1966. Research groups have published certain materials on the subject. Prominent of these research groups are the Council of Economic Development, Council of Economic Priorities, Council of Trends and Perspective (a group organized by the U. S. Chamber of Commerce), the insurance industry's Clearinghouse on Corporate Social Responsibility, and a few others.
will be analyzed, and arguments will be formulated to strengthen the case for corporate social involvement through the formulation of social and economic rationale for the concept. Moreover, an operational definition of the concept will be offered, and sets of criteria for establishing the limits of corporate social responsibility will be developed for setting up social program priorities.

The Modern Corporation in a Free Society

The modern corporation is a social institution. It is a tool, and the nerve-center of virtually every economic interaction and cooperation among society segments. Therefore, its existence is not a random process; it exists to serve a specific purpose, and "its existence and decisions can be justified only insofar as they serve public or social purposes."

William T. Gossett, a former vice-president and general counsel of Ford Motor Company has this to say about the modern corporation:

The modern corporation is a social and economic institution that touches every aspect of our way of life. During the past 50 years, industry in corporate form has moved from the periphery to the very center of our social and economic existence. Indeed, it is not inaccurate to say that we live in a corporate society.

In a modern industrial society, the basic economic concern of all sectors is the production of goods and services. This involves the organization and coordination of vast resources -- men, materials, and

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machines -- the success of which is gauged in terms of productivity, profitability and growth. This organizing device is the modern corporation which is considered as one of "the most important changes in man's social history."22

For many of its members (like the managers, employees, owners, etc.), the modern corporation is a lifetime experience. Therefore, its commitment to the production of goods and services is no longer an all-encompassing objective. This goal has to be balanced with providing a satisfactory way of life for its constituents, and the attainment of the goals and aspirations of society as a whole.23

As a social institution, the corporation is enduring. In instances where the traditional ties of society have disintegrated, the modern corporation has taken their places. Daniel Bell summarizes this point in this manner:

...To the extent that the traditional sources of social support (the small town, church, and family), have crumbled in society, new kinds of organization, particularly the corporation, have taken their place; and these inevitably become the arenas in which demands for security, justice and esteem are made.24

In legal parlance, the corporation has a juridical life whose existence is in the abstract. This legalistic view of the corporation is appropriate only in so far as its traditional role is relevant.


24Ibid.
As the corporation moves from the economizing mode to sociologizing mode, its abstract existence loses its meaning for the corporation's institutionalized character has been moved from the abstract to something real. Such corporate realities are felt by society as individual decisions are made in the marketplace. In recent counts, about two-thirds of the non-agricultural productive assets of the nation are under the control of the first 500 leading corporations. In 1970, they employed 14.6 million workers, or more than 75 percent of all employment in manufacturing. This vast concentration of business power mesmerized the skeptics. Ralph Nader, for one, argues that the corporation derives its strength at the outset from what it gets not from what it receives. He pointed out that "its inherently acquisitive nature permits easy justification for wide discretion as to when and how to use or not to use the many permutations of its power." In this sense, concludes

25Daniel Bell defined economizing mode as the science of the best allocation of scarce resources among competing ends. This is a technique of reducing "wastes." The conditions of economizing are a market mechanism which functions as an arbiter of allocation and a price system which is responsive to the supply and demand patterns. Sociologizing mode refers to the effort to judge a society's needs in a more conscious fashion and is based on a certain conception of the "public interest." Ibid., p. 14.


27Bell, op. cit., p. 6.

Robert Dahl, the modern corporation shall be viewed as a political system whose leaders exercise great power, influence and control over other human beings.29

On the other hand, the wide discretion and the economic power which corporations possess can be harnessed towards the attainment of social goals. This allows the corporation to perpetuate itself not only in terms of its economic motives but also in terms of the expectations of society. However, in making it responsive to such expectation, it is imperative that the modern corporation should not just be a "receiver" of society's expectations, although, it is a tool of attaining them. It should work towards a mutuality of purpose with society. Acceptance of an expectation shall not promote or result in passivity on the part of the corporation. It must articulate the logic of these expectations as well as their possible outcomes. As Day pointed out:

As a microcosm of society, a corporation must reflect all of that society's share values -- social, moral, political, and legal as well as economic. It must change as society changes; but as a dynamic institution, it can also seek to influence the ultimate form and expression of those changes.30 (Emphasis added).

Conflicting Views on Business Involvement on Social Issues

While the role of the modern corporation is under careful scrutiny, the responsibility of business as a whole in promoting social goals, other than the profit motive, is the subject of a raging contro-
versy under the label of "corporate social responsibility." The basic issue lies on the question as to what constitutes the optimal social role of a business enterprise. There are essentially two ideological positions in this debate: the free enterprise creed or the "classical" view and the social responsibility creed or the "managerial" view.

Free enterprise creed - Headed by the contemporary economist, Milton Friedman, the free enterprise creed upholds Adam Smith's thesis that all business firms serve the total society by earning the greatest possible profit within the existing legal and ethical framework. In this pursuit of maximum profits, the corporation is guided by an "invisible hand" which result in the maximum good for society through the functioning of competitive forces in the marketplace. Underscored in this creed is the fact that firms have to pursue maximum profits and, therefore, any deviation from it in terms of pursuing other goals will imperil the "invisible hand." In summarizing the "classical" school, Economist Robert L. Heilbroner quoted a 1926 disciple: "It is inconceivable to a 100 percent American that anyone except a nut should give something for nothing."31

Accepting its assumptions, the logic of the "classical" argument is almost faultless; but the democratic marketplace conceived by Adam Smith in constructing the "invisible hand" was a society of small English merchants competing with each other in the 18th century. Today, that world no longer exists, and therefore, the reality of the basic assumption of the "classical" argument is based on fantasy and make-

believe.

**Social responsibility creed** - The proponents of this creed hold that the free-enterprise, maximum-profit philosophy is an anachronism; and that it makes no sense in today's society where huge corporations play not only a vital economic role but also an important political and social roles.\(^{32}\) For the "managerial" view, profit is a means to an end; not an end in itself. As Joseph McGuire noted, the men who adhere to the social responsibility doctrine recognize that they are men first and businessmen second.\(^{33}\)

The managers of large corporations operate in an extremely complex environment to the extent that certain results of a decision are often unintended. Quite often, therefore, the consequences of a decision are innimical to the public interest. Consequently, it should be recognized that social responsibility is a factor imbedded in the decision-making process. Jerry L. Kinard notes this point vividly:

> A business enterprise cannot operate without regard for the society which serves its needs and which, in turn, is served by its operations. As a business firm grows in size, its responsibilities take on new meanings. Whenever a leading firm takes action, its decision affects the economy and reverberates throughout the social structure. A decision by a major concern to expand or curtail production, for example, may precipitate an economic boom or a recession not only within its immediate locality but also throughout the nation.\(^{34}\)

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\(^{32}\)Ibid.

\(^{33}\)McGuire, op. cit., p. 147.

But the "managerial" view is not free from its own critics, independent from the "classical" school. These critics reject completely the "classical" view while disagreeing with the arguments of the "managerial" school. They accept the proposition that business has to play an important role in realizing social goals, but they are skeptical about this corporate involvement because they (1) fear about the additional power which the corporation may acquire; (2) question the legitimacy of corporate power exercised by the managers; (3) question the choice of corporate activity which is unilateral, and not democratically determined; and (4) fear, most of all, what they call a "corporate state." 35

The above views are defended convincingly by their proponents; not mentioning the fact that they are leaders in their respective disciplines.36 But there are flaws in their arguments which need to be articulated to appreciate fully the controversy. This will be attempted in the later section of this discussion, but first the urgency of a


36The "classical" view carries such names as Milton Friedman, Michael Harrington, Theodore Leavitt, and scores of businessmen; on the "managerial" view, such names as Peter Drucker, Adolph Berle, John K. Galbraith, Keith Davis, Philip Blumberg, Daniel Moynihan and countless leading names in business and the academic world. Those raising the dangers of a "corporate state" are mostly young and talented activists like Ralph Nader, Larry Finkenstein of the National Committee on Government Secrecy, and many others who are, at the moment, taking a low profile, but maintaining considerable pressure on leading government figures in Washington.
conceptual and operational understanding of the catchall "corporate social responsibility" has to be overcome.

**Meaning of Corporate Social Responsibility**

Social responsibility is a nebulous concept that lacks precise definition. Phil Drotning, the director of social responsibility at Standard Oil Company (Indiana), and considered one of the leading authorities on this subject in the country today, complained before the Scholar Program participants of the National Affiliation of Concerned Business Students (NACBS),[37] that his company is deeply involved in this concept without having a clear definition of what it is. William C. Norris, President of Control Data Corporation, summarizes the typical businessman's view of corporate social responsibility:

> The term social responsibility can be interpreted in many ways. My definition may be different from yours....

Ultimately, social responsibilities must be better defined so that corporations know their obligations to society. There are many complex and often conflicting requirements. Corporate resources are not nearly large enough to solve all the problems, but I believe corpo-

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[37] The National Affiliation of Concerned Business Students (NACBS) is a group composed of business students and faculty members from the leading business schools in the country as well as leading figures from various disciplines who are propagating the social responsibility creed. Recently, it launched a project, the Scholar Program, supported by the Ford Foundation, whereby six business students (this writer is one of the "scholars"), from these leading business schools were selected to work with six large companies to find a solution to the problems encountered in pursuing their socially-relevant projects. Phil Drotning is the head of the group that represents the six participating companies.
rations want to help, not only because of altruistic reasons but also because it is the right thing to do, and it is in the best interest of business to do it.\footnote{Professor Gray of the business school at Louisiana State University stated that there is some agreement as to the meaning of the concept in general terms. In a minimum sense, social responsibility involves an expanded awareness on the part of the businessman of the social environment in which his firm operates, and a commitment to help in the solution of social problems.\footnote{Keith Davies offers a conceptual definition by saying that social responsibility refers to the "businessman's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest." A similar definition is suggested by Steven Dilley: The performance (or non-performance) of activities by the private enterprise without the expectation of direct economic gain or loss for the purpose of improving the social well-being of the community or one of its constituents.} (Emphasis added)

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tuent groups. The activities are those generally recognized by society and/or the law as beneficial to the well-being of the society.41

These definitions42 are quite broad which tend to overwhelm businessman, leaving him in quandary as to the extent of this responsibility, given the constraints of competing goals that require limited company resources. Therefore an operational definition is needed that would serve as a guide to the businessman in pursuing social goals. This operational definition -- actually a limit-setting type of definition -- may be formulated around three dimensions or considerations: (1) define social responsibility in terms of compliance with the law; (2) define the concept in terms of activities over and beyond the requirements of the law; and (3) voluntary activities in response either to public pressure or to the plain sensitivity of management to social issues.

Compliance with the law - Defining social responsibility in terms of compliance with the law, assuming that such a law exists, has certain outstanding merits. R. C. Mallatt, Manager, Environmental Conservation Office, Standard Oil Company (Indiana).


expounded this point. He argues that government standards will serve as a guide for a company's action and response program to avoid an "overkill." Because of resource constraints, continues Mallatt, an "overkill" will take away certain funds which could be devoted to other worthy projects requiring similar attention. The logic of this position is pragmatic. It promotes a way for the corporation to meet its obligation to its stockholders and to the public, for the law represents a public policy. In addition, the law will provide a basis for setting up a type of corporate model of compliance which satisfies the requirements of good corporate citizenship and the maximum profit objective for the firm's stockholders.

Several criticisms could be raised against this method, however, they could be answered convincingly:

(1) The method places a limit as to what the corporation may undertake. This may be true, but not entirely tenable. In fact, whether or not there is a law, corporate activity in this respect is constrained, at least in the short run because of management's perceived responsibility to its stockholders.

(2) The standard set by law may not be enough. Mallatt shelves this criticism because he maintains that the legal requirement if properly set up has a built in "margin of safety" to cope with the problem.

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43 Based on the writer's discussion with Mr. R. C. Mallatt, it should be noted that these standards may be desirable for social concerns as pollution abatement because of the enormous resources required.
(3) The standard diminishes individual initiative on the part of the businessman. This criticism can be dismissed outright for with or without the legal standard, a socially-sensitive businessman will assume responsibility. The law will become the minimum, or a measure of initiative for the legal requirements forces initiative.

(4) Once the legal requirements are formulated, they remain indefinitely. This criticism may be true, but society requires responsibility from the law-making bodies, as much as responsibility is demanded from corporations.

Beyond the requirements of law - Defining social responsibility according to this criteria may be ideal, but certainly unrealistic considering the economic motive of a corporation and the limits of its resources. In fact, this may prove to be a deterrent towards a socially-inclined behavior of businessmen. They would tend, as it is today, to think that social responsibility is incompatible with the profit motive.

Voluntary response to public pressure or management sensitivity to social issues - A definition of social responsibility along these lines may, perhaps, be the least desirable and the most potent incentive to undesirable and irresponsible business behavior. For instance, the question is raised whether or not U.S. Steel is socially irresponsible with a miserable record on air pollution control but outstanding in supporting Harvard University. Of course, most will invoke a value-judgment-dispensation for this question. But according to the guidelines that will be proposed
later, U.S. Steel is irresponsible because the company might have chosen the support of Harvard because the cost is tremendously cheaper than cleaning its pollution problem. Another undesirable behavior that may result is the case of a businessman depicted in a cartoon who asked his marketing executive: "So our budget for social projects this year is $1 million, and $2 million to publicize them?"

The above points have provided an insight into the boundaries of an operational definition of social responsibility. But it does not provide the businessmen with a scientific method of setting up priorities as to what socially-relevant program to undertake in an effort of maximizing the impact of his limited resources committed to alleviating the problem. Consequently, the following guidelines, in their sequence, are suggested in selecting the social project which the firm might undertake: (1) social concerns within the firm's area of disturbance; (2) social concerns within the firm's area of operation; (3) social concerns which the firm has the necessary expertise; (4) social concerns not included in (1), (2), and (3) above having an impact on the community where the firm is located; and (4) the same as in (4) above, but the impact is beyond the firm's location. A brief discussion is necessary to explain the significance and the application of these guidelines.

**Area of disturbance** - As used in this context, the firm's area of disturbance encompasses the particular social problem which the firm contributes directly either partly or wholly, to its cause. Thus, if the company pollutes the river, its area of disturbance is
polluting that river. Under this guideline, it becomes a primary responsibility of the company to alleviate this problem ahead of all other social concerns, provided that it has no direct participation in causing them. Simply stated, this guideline says: "clean up your own mess."

**Area of operation** - This refers to the social problem caused by the industry within which the company operates. The main distinction between the problems falling under this guideline and those identified with the first guideline above is that under the latter, a problem can be alleviated unilaterally, like air and water pollution. Whereas the problems classified under the former cannot be corrected by one or more firms, but only through a concerted effort of the whole industry. An example of this is the hazards of smoking which is undoubtedly a problem of the tobacco industry. The degree of responsibility in this classification is similar to the first guideline above, only that the response time for the latter is quite faster than the former.

It should be noted that the first two guidelines above require compulsory action which may well be required by law. The next three guidelines discussed below are voluntary in nature.

**Existence of necessary expertise** - Social concerns which do not fall under the previous guidelines, may be classified in this category provided that the company has the needed expertise to cope with the problem. Although involvement in these problems are voluntary, the pressure to respond is more intense due to the existence of such expertise. For the purpose of setting up
priorities under this category, the company may want, depending upon how it perceives its operation, to test the problems in accordance with the next two guidelines discussed below.

**Social problem having a direct impact on the firm's location** - These are social concerns which do not fall in either one of the above. Priority-wise, this takes precedence over the problems classified under the last category below because of its local significance. For instance, McGraw-Hill supports urban renewal programs in New York City because they have a significant impact on attracting potential workers in the area.

**Social problem whose significant impact goes beyond the firm's location** - These are problems of wider significance which should generally fall at the bottom of the corporation's priority list. An example is a firm's contribution to the Boy Scouts of America.

The application of the above criteria is presented in a decision flow chart in Figure 2.

**Social responsibility defined** - Considering the points raised above, a definition of social responsibility is suggested

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44 The company may perceive its operation as local, statewide, national or multinational. In recent years, corporations have been changing from a "cartesian view" whereby products are conceived individually as influencing overall strategy, to a "holistic view" in which conditions and patterns determine products. Thus, Xerox Corporation perceives its operations as in the communications business, rather than in copying machines. Likewise, the automakers view their operation as in the transportation business rather than in the making of automobiles. See Hazel Henderson, "Keeping Informed: Ecologist versus Economists," *Harvard Business Review*, Vol. L1 (July-August, 1973), p. 29.
Identify Social Problem

Area of Disturbance

Yes

Do Something

No

Area of Operation

Yes

Do Something

No

Compulsory Criteria

Voluntary Criteria

Do you have the necessary expertise?

Yes

Is it a local problem?

Yes

Do Something

No

Problem beyond local impact?

Yes

Do something

No

To A

Stop

Would you like to do something?
as referring to the businessman's decisions and actions, voluntary or in compliance with law, without the expectation of direct economic gain, for the well-being of society or for one or more of its constituents. Decisions and actions are determined based on the following guidelines: (1) area of disturbance; (2) area of operation; (3) existence of the necessary expertise to do the job; (4) impact on the firm's immediate location; and (5) impact beyond the location of the firm.

**Significance of definition** - The definition has several interesting features which makes it more elaborate than the previous definitions cited above. First, it is explicit as to the intent of the enterprise regarding the social problems caused or aggravated by it (as defined under area of disturbance and area of operation). In other words, if the social problem falls under these first two guidelines, the enterprise has a primary responsibility to alleviate it, either as required by law, due to public pressure or just plain conscience. Second, it distinguishes between voluntary and involuntary activity. But it does not render an involuntary action as socially undesirable because, as suggested previously, legal standards are needed for problems requiring the large sums of money such as air and water pollution. On the other hand, a lavish support for an educational institution while neglecting its primary responsibility as defined under area of disturbance and area of operation may render the corporation socially irresponsible. Third, the definition is explicit as to the expectations of the enterprise, that is, no economic gain (but it could be a loss).
Fourth, the term "well-being of society" is made explicit as the benefits that accrues to society as a result of the socially desirable actions of the enterprise. Fifth, the suggested guidelines reinforces the operational feature of the definition because the businessman can rank the social problems before him, resulting in the setting up of priorities for his action-response model. This maximizes the impact of his limited resources.

Finally, conceived in the definition are two major points which would be extremely useful in taking a hard look at corporate social responsibility.

(1) The definition and the proposed guidelines provide a straitjacket answer as to who is irresponsible and who is not. When a social problem falls under the first two guidelines and the offending firm does not provide a way for its remedy, then such firm is irresponsible. On the contrary, if the social problem is classified under either one of the last three guidelines, the situation becomes a value judgment. But as stated, the pressure to act is heavier if the company has the necessary expertise. More importantly, the guidelines provide an explicit answer to the question: Is U.S. Steel whose pollution control record is miserable but lavishly supporting Harvard socially irresponsible?

(2) Also conceived in the definition and in the guidelines is that each guideline will work as a modern day version of Adam Smith's "invisible hand" as it applies to solving social problems. The only difference, however, lies in the fact that Smith's "invisible hand" works via the forces external to the firm, that is,
forces in the marketplace. This modern adaptation of the "invisible hand" works within the firm's social program activities. For example, if every water polluting firm will follow the rule "clean your own mess" (area of disturbance guideline), water pollution would be prevented, and perhaps, eradicated altogether as firms maximize their pollution control output.

**Bridging "Classical" and "Managerial" Views**

For every disagreement, as the saying goes, there is always a potential for agreement after all two reasonable factions cannot be disagreeing forever, especially when the resolution of the conflict is vital to human existence. But the beauty of disagreements is that they articulate the less apparent aspects of the problem being debated upon. And the responsibility of the protagonists -- intellectuals or otherwise -- is to scientifically sort out the areas of agreement from those points of disagreements and concentrate on the latter.

For years, the debate between the "classical" view and the "managerial" view of corporate social responsibility has been highly theoretical, despite the fact that the problem debated upon is real and requires a highly pragmatic approach to its solution. The "invisible hand" of the "classical" school did not make the river cleaner; nor the exhortation of the "managerial" view to make businesses socially responsible made a significant impact on cleaning the water. The reality of the matter is that while the controversy rages, businessmen are asking: What is this social responsibility all about? What am I supposed to do? What are its
limits? This fact was made obvious to this writer in his contact with various companies, in business forums and seminars, in his public practice of accountancy, and for being a "scholar" in the Scholar Program of the National Affiliation of Concerned Business Students (NACBS).

Both the free enterprise creed (or "classical" view) and the social responsibility creed (or managerial" view) agree to maximize profits for the stockholders, only that the social responsibility group is asking the businessman to do something about the bad effects or "spillovers" of his activities. The free enterprise proponents, however, would not want the businessman to be bothered from his pursuit of profits. They would like society to decide what to do about the "spillovers," that is, should the solution come through the political system or through the workings of the marketplace?

On the other hand, the social responsibility proponents do not make their position clear as to what extent shall pollution control, for example, be pursued. The free enterprise advocates invoke the economists cost-benefit analysis, that is, if the incremental cost of reducing pollution is larger than the cost of having pollution, society is better off by having the latter.

However, these differences are the points of disagreements at the surface. A new dimension in the controversy emerged during Friedman's interview with Business and Society Review. Mr. Friedman maintains that any action by the corporation to commit its resources in the name of social responsibility is nonsense. Such action is
public relations which is intended to enhance profits. In other words, if a company spends money to improve the conditions of the community where it is located, Friedman argues that it would be to the self-interest of the firm, and "may be the cheapest way it can improve the quality of the labor it attracts." Undoubtedly, to the social responsibility advocates, this gesture is more than just self-interest; it is good corporate citizenship under the social responsibility concept.

The interesting point, however, is that there seems to be no real world difference between these two protagonists except in concept and in the terms being used. The conceptual difference is understandable, considering the foundations and assumptions upon which the "invisible hand" has been built. For one thing, Friedman does not object that the corporation shall help improve the community for it is just pursuing its self-interest. Unquestionably, the terms used -- public relations for Friedman and social responsibility for the "managerial" view -- are unimportant so long as corporate action reflects responsible behavior.

A Case for Social Responsibility

In October 1973, Kirk Hanson, President and Executive Director of NACBS, attended two conferences on corporate social

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45 Ibid., p. 7/.
policy which he described one of them as "the year's most extravagant corporate responsibility conference," that brought together 200 corporate and academic luminaries. His report reads:

It was clear at these meetings that there is one great cause for concern amongst advocates of corporate social policy: no one has articulated a coherent and persuasive rationale for initiating corporate social policies and programs .... It is clear already that some retrenchment is taking place as memories of riots fade and public pressures are less novel than they used to be.  

Hanson concludes that the "development of such an underlying rationale -- one based firmly in concern for the long-run survival and profitability of the firm -- is the most critical task facing all of us."

These statements underscored the inadequacy of the available literature on the subject. Most writings are based on a vaguely conceived justification for socially responsible behavior of corporations. Therefore, this section will attempt to provide a basis for developing such social and economic rationale.

Social rationale - Business is the backbone of a capitalist society. As such, an attempt to establish a social


48 Business and Society Review is almost exclusively devoted to problems of this nature. Other similar articles are abundantly published in The Conference Board Record since the early sixties. See Footnote 19 for sources of articles on the subject.
rationale for corporate social responsibility shall begin by looking at business as a social system. Within this system are subsystems which are composed of the corporation, managers, employees, creditors, suppliers, customers and the general public. As part of the social web, each of these subsystems has a particular function to perform. Evidently, any malfunctioning or any action by one or more subsystems which would be innimical to the interest of other members of the web would upset the balance, and therefore, conflict will arise.

Relevant to this discussion is the behavior of the corporation and the managers that creates a considerable concern for the other subsystems. Consequently, an attempt shall be made to formulate guidelines or levels of analysis which would serve as the foundation for developing a social profile for the corporation and the managers. This social profile would be extremely helpful in understanding and developing a rationale for their involvement in pursuing social goals.

(1) Social profile of the corporation - Earlier in the discussion of the role of the modern corporation, it was suggested that the legalistic abstract existence of the corporation is no longer responsive to a technological society such as ours. It was concluded that as the nerve-center of almost all social and economic interactions among the society segments (or subsystems), the existence of the corporation is real, no longer in the abstract, for its presence reverberates throughout every fiber of our society. This conclusion establishes the firm position of the corporation in the social web.
Again, reading back into the earlier exposition of the role of the modern corporation, it is evident that its social relevance could be synthesized under four broad interrelated levels: (1) it is a social institution which possesses vast economic power and resources; (2) it is the core of the economic activities of a capitalistic society; (3) it is society's prime mover and a change mechanism; and (4) it exists as a "corporate citizen" in our society today. A brief elaboration of these guidelines or levels to complement the previous discussion is necessary.

The corporation, argues Daniel Bell, is a social invention of the Middle Ages intended to carry on a common activity. Here, ownership was clear for the members were directly involved in its governance. The modern times, however, has charged the pattern. Ownership becomes a legal fiction for true ownership means involvement directly and psychologically in the fate of the enterprise. This description better fits the employees who have depended every aspect of their lives in the corporation. Apparently, this is a manifestation of the popular belief of a number of social thinkers that the corporation is a dynamic force to make the dreams of the technological study a reality. The late sociologist W. I. Thomas summarized this point in his "four wishes" which were considered basic to human experience and can be obtained only in the corporate milieu -- the wish for security, for new experience, for response, and for recognition.  

\[^{49}\text{Bell, op. cit., p. 21.}^{50}\text{Ibid., p. 17.}\]
The possession of and the use of vast resources are both a right and a privilege; while the possession of and the exercise of power are a privilege bestowed upon a few. But whether or not these possessions are a matter of right or privilege, society has both a written and unwritten code that they be overseered by a corresponding responsibility. For instance, society makes the right to property not absolute for owners are restrained from using their property if the outcome would be detrimental to others. Recently, the technological American society has expressed in its tax system to the effect that the affluent shall take the heavier burden of providing for public services. Moreover, it is a public policy of this country to send assistance to unfortunate countries afflicted by hunger and disease or suffering from the malady of under-development.

In a performance conscious society, attaining considerable power is inevitable for the corporation. As Rostow puts it:

"The corporation in its familiar form has become an accepted instrument of social policy -- indeed, the chosen instrument of the law for carrying on a large part of the economic life of society."\(^{51}\)

John K. Galbraith added that the "great corporation has powerful enough leverage in the community that getting what it needs from the government becomes pro tanto sound public policy."\(^{52}\)

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society demands responsibility in the exercise of power. On the minimum, this is expressed in the rule of law of our democratic way of life.

As in the case of a capitalistic society, the large corporation determines the limits of productivity of our economic system. Peter Drucker summarizes this point in this manner:

...their labor relations set the standards for the nation, their wage scale determines the national wage scale, their working conditions and waking hours are the norm, etc. While the corporation do not control a majority of the nation's business, its prosperity determines the prosperity of the nation.\(^{53}\)

As the locus of all economic activity, the corporation provides a pooling of the productive resources of the nation. It provides a forum for individual initiative and motivation as well as allowing a free interplay of all human talents. As Robinson Barker contends, "As an organ of innovation, the corporation, of all social institutions, is the only one created for the express purpose of making and managing change."\(^{54}\)

Finally, as a corporate citizen, it has the responsibility as any other individual, to promote harmony among the members of the community. It is for the self-interest of everyone to protect the fabric of society from being ripped to shreds. Unquestionably, no one wants to experience anew the civil disobedience and the riots of the early sixties.


(2) **Social profile of corporate managers** - The social profile of the managers can be based upon three broad areas of responsibility; first, in his capacity as manager of the corporation; second, as a professional manager; and third, as a member of society.

All these three areas require a sense of personal responsibility from the manager; a requirement which bears heavily with the traces of the personal values of the individual concerned. Boulding made an interesting attempt to define personal responsibility. He starts by invoking love as the greatest of the Christian virtues, and since one cannot feel the same depth of emotion (although the teachings of religion commanded everyone to do so), for all the inhabitants of the earth than his feelings towards those near him, the claims of love, Boulding maintains, can be reduced to a reasonable dimension by defining and limiting responsibility. For him, "the idea of responsibility is a reasonable first approximation of love, especially in dealing with the complex relationships of economic life."  

Or if we look at the matter from the point of view of different levels of abstraction, we may say that responsibility implies certain extension of self, in that we are concerned for the welfare of others as well as for ourselves; and it is precisely this extension of self which is implied in the concept of love.  

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Boulding proposes the following meaning of responsibility, dissecting the term into responsibility for and responsibility to:

**Responsibility for (internal responsibility)** - rests in inner sense of concern for the other person and at least a partial identification of his interest with ours, a sharing of his joys and sorrows.

**Responsibility to (external responsibility)** - concerns with the locus of power and the structure of organization. We are responsible to people who could put as out of our job if we don't satisfy them.\(^{57}\)

**As manager of the corporation** - As a leader of vast resources of men, materials and machine, the manager has to recognize his responsibilities to the corporation and to his constituents -- stockholders, employees, suppliers, creditors, and the public at large.

With regard to the corporation, the manager is responsible to secure its long-term viability; to the stockholders, he is obligated to secure the highest possible profits within the constraints imposed by the interest of the remaining constituents; to the suppliers and creditors, his obligation is to treat them fairly and justly; to the employees, he has the obligation to allow them to enjoy a fair share of their toil, and to help them attain their aspirations in life. Finally, the general public deserves to be informed about the true picture of the corporation's activities and the responsibility it assumes to enhance social goals as well as providing for the best service possible at a reasonable price the public could afford.

**As a professional manager** - As a professional man, the

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\(^{57}\)Ibid.
manager has a responsibility to the public and to his profession. 58

With regard to the public a professional shall take full responsibility of his actions. While admitting that the manager operates in an extremely complex environment, the failure to exercise care and foresightedness in evaluating the possible outcome of a decision is understandable but certainly indefensible. G.A. Patterson, President of the Institute of Chartered Accountants of Scotland has these words about the responsibility of a profession and the professional man:

A profession is something more than a job or an employment, and includes elements of dedication of unselfishness of responsibility and integrity. The professional man, if he is to play his full part in the community, must be prepared to accept full personal responsibility for his actions -- when things go wrong, no less than when they are going well. 59

The manager's obligation to his profession is utmost loyalty, and the responsibility of enhancing its status. Peter Drucker underscores the latter point: "Executives have the responsibility to advance the art of business management if it has to have the status of a profession." 60

58 The question whether or not business management is a profession, is beyond the scope of this discussion. However, the literature is replete with scholarly expositions on the subject.


As a member of society - As a member of society, the manager has two levels of responsibility: to the community where he resides, and to himself as an individual. His obligation to his community requires good citizenship and sensitivity to social activities where his skills and leadership are indispensable. The manager's responsibility to himself encompasses many aspects. One of them as conceived in this discussion is for the manager to articulate in the decision-making process his own convictions about a decision to relieve his conscience of potential strain. Albert Carr tells of a friend who has been bothered as a result of an undesirable conduct of his company's operations. He made this observation:

But conscience is never killed; when ignored, it merely goes underground, where it manufactures the toxins of suppressed guilt; often with serious psychological and physical consequences. 61

(3) Corporation - manager social profile - With the manager at the helm, the corporation is transformed into a solid machinery for carrying out the necessary activities towards the attainment of its goals. The manager becomes a trustee for the corporation as well as its action-maker. In this regard, two levels of responsibility are identified, the burden of which falls on the manager. The first level requires the manager to act as a mediator of the various, and more often conflicting interests of the

corporate constituency. As such, it is imperative that the manager should stay neutral in the process. The second level requires the manager to restrain the exercise of corporate powers. This is part of the "countervailing power" which Galbraith has expounded to the effect that strong and powerful unions, for example, offsets the control of strong and powerful firms.⁶² A. A. Berle suggested that this could be accomplished through the attitudes of corporate managers, which are limited to some extent, at least, by society's norms and values. Apparently, this entails a strong sensitivity to the attitudinal shifts of the corporation's constituents. Insensitivity to these changes would upset the balance among the interests of these constituents; thereby opening the possibility of conflicts. However, both sensitivity and insensitivity to social issues have certain basic dangers. Warns William Casey, former Commissioner of the Securities and Exchange Commission:

Corporations can hurt themselves by failing to be sensitive to these demands or by being so acutely sensitive that they lose sight of their customers, and investors, and provide challenge and opportunity for their employees. By failing to respond, they can lose touch with the world around them; by overspending they can incapacitate themselves.⁶⁴

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Moreover, Peter G. Peterson, former Secretary of Commerce and currently the board chairman of Lehman Brothers added:

One yardstick I have found useful in assessing the real strength of a company ... is how much time its very best people could devote to the future. Wherever I saw most or all of the company preoccupied with today's and next month's and even this year's problems -- very frequently, I found, it was an enterprise that either was in or was headed for, trouble.

Conversely, the best managed corporations, I found, invested substantial amount of their most precious resource -- the time of their top managers -- in the future; protecting the future; and defining the problems and the opportunities of the future; and deciding how to best shape the future instead of being shocked by it.\(^6^5\)

**Economic rationale** - The previous discussion has attempted to formulate guidelines or criteria to serve as a foundation for developing a social profile for both the corporation and the managers. This section will attempt to develop an economic rationale for corporate involvement in social concerns.

The economic rationale for corporate confrontation with social issues is being fought between Friedmanism (also called "classical" or free enterprise creed) and the "managerial" or social responsibility creed in a frame of total aggregation of the issues. As pointed out earlier, it is evident that Friedmanism does not object if the company helps improve the community where it is operating, as long as the company, or anybody for that matter, would not brand it in the name of social responsibility. For Friedman,

such an actuation is public relation, and would enhance profit. In this context, profit is an aggregation of the two dimensions of profit and profitability -- short-term and long-term.

On the other hand, the "managerial" view fielded its arguments more on the moral and ethical aspects of the question. The result is that not only that this view fails to confront the Friedmanism argument but also losses the opportunity to build its arguments on a common basis with the opposing view, that is, arguments based on profits. Consequently, to put the two views on a common basis is actually developing an economic rationale for the "managerial" view.

Although short-term and long-term profits or profitability are related to each other, they are subject to different constraints, both internal and external. The internal constraints consist in the main, of the goals and objectives of the company which may either require a short-term, long-term or both, maximization of profits. Undoubtedly, whatever goal is chosen, trade-offs are inevitable. Thus, a short-run maximization of earnings per share, may sacrifice the long-term profitability of the enterprise. Or a maximization of short-term profits may destroy the company and the entire industry. A good example of this is the whaling industry which is now at the point of extinction. Another example is the steel industry which according to one account says that if certain divisions of the major steel manufacturers are forced to reduce air and water pollution as required by existing laws, it would be
more economical to build a new plant than to improve existing ones.

The external constraints consist of the general conditions in the marketplace as affected by environmental factors as social, political and economic. Thus, changing life styles and consumer tastes and preferences if not acknowledged by the company may affect market share, thereby endangering the long-term profitability of the company. Or marketing shoddy products may maximize short-run profits but it certainly compromises the long-term profits. Likewise, a wanton disregard for the environment may invite political intervention which may affect the long-run viability of the firm.

With the above frame in mind, the economic rationale for corporate social involvement based on long-run profits or profitability is obvious. A few examples:

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66 As told to this writer by an individual who has been working in the steel industry for quite sometime.

67 Unquestionably, Friedmanism is a short-term view of profit or profitability while, the "managerial" view takes the long-run aspects of profits or profitability. It could be argued, however, that with the advent of social responsibility controversy, the freedom of choice is articulated which gives the corporation a choice as to what goals to pursue. This argument opens up at least to two main important points: (1) it sustains the unsupported claim of a few including a Dreux Corporation executive that "the managements which look after pollution control, consumer protection, and minority hiring are going to be the really profitable ones in the future; (See Robert J. Schwartz, "A Cold Eye on Guilt-Eyed Investing," Business and Society Review, No. 3 (Autumn, 1972), p. 86), and (2) the trend towards more disclosures of company affairs as either required or suggested by the Securities and Exchange Commission, the accounting profession and other groups, assuming that the investing public would desirably behave against a "quick buck," Adam Smith's "invisible hand" might start reallocating resources in favor of desirable and responsible enterprises.
-- Supporting education may have a short- and long-run effect on the company's operation. The short-run consists of the good image the company projects to the industry-antagonistic youth in schools. It is a common knowledge how students prevented a company, Dow Chemical for one, from recruiting in a major school campus. The long-run perspective involves a sense of assurance that industry would have a steady supply of well-educated and well-trained working force. Moreover, it is now a part of our legal jurisprudence the case of A.P. Smith Manufacturing Co. vs. Barlow in 1953 whereby a suit was filed in court restraining the company from making contributions to a school. The Supreme Court of New Jersey upheld the desire by the corporation to insure and strengthen the society which gives them existence.68

-- Helping improve the community where the company is located may have a tremendous effect on the quality and productivity of the work force. This is demonstrated by allowing breaks to employees during their working hours which result in increased productivity.

-- McGraw-Hill is taking an enlightened view towards its contributions. First, it took a "holistic" view of its operation as in the communication and education business being a publisher. So its main contributions go to activities to promote its area of operation. On top of this, it took a view that New York City is suffering from a shortage of quality work force because such employees are leaving the city. So certain contributions are allotted to urban affairs activities as well as to the arts to attract good workers.69

-- Minority hiring and helping minority businesses is a way of placing the minorities in this country into the mainstream of American life through their own motivation and hard work. This would minimize welfare, and most of all prevent another Watts and other problems of the sixties.


69 As discussed in one of the monthly meetings of the MACBS Scholar Program.
Public policy is against the continued degradation of the environment. Failure to alleviate pollution may cost more to do in the future. Costs may involve restoring a past damage and/or preventing current and future damage. To these costs shall be added the effects of governmental intervention, the bad publicity, problems in recruiting labor especially the youth in school today, the public relations problem that will result, etc. Obviously, these are hidden costs which have long-term implication.

The decision of the oil industry to increase their 1973 profits as much as 59 percent from last year may have either short- and long-term effects. The short-term effect is that profits increased considerably but may be the cost of such a decision have not been assessed carefully. For instance, governmental intervention is shaping up, the results of public's furor is ascertainable at this point, the outcome and the possible effects of the truck strike is still unknown, the cost of television time explaining these increased profits may be tremendous. The long-term implication may include the uncertainty of what the government in response to public disenchantment would do.

On the other hand, it could be that the problem on oil prices may be settled once and for all forcing the government to take a hard look at its policies. Moreover, the public will realize that the possibility of oil shortage is real, and the use of it will cost more. Also, this might result in what the marketing discipline is propagating now -- responsible consumption. This would mean that consumers will take a new view of cars as a means of transportation and no longer as a status symbol. Of course, General Motors which is the principal manufacturer of big cars may suffer a reduction in sales of big cars in the short-run but will increase sales of small cars in the long-run. In the end, a real conservation of energy as well as steel and other materials used in manufacturing cars may be realized.

Professor Kristol argues that the oil companies did think economically, but failed to think politically. Thinking economically, he maintains means "trying to discern the opportunity that every problem gives rise to." Thus the oil companies took the opportunity of raising their prices during the oil embargo. Thinking politically means "trying to discern the problem that every opportunity gives rise
Business does not thrive in a turbulent and a near-chaotic environment. The experience in the Philippines which was the result of oil price increases by the major American oil companies operating in the islands is a classic example that affected both American and Filipino businesses. The situation was described by this writer in a case paper written for a class in business and society:

On Monday morning, January 8, 1971, after the working men have gone to work, the transport strike started. At 9:00 A.M., major thoroughfares were deserted; human barricades were set up in strategic streets; taxicabs and buses were stoned; a cab and a bus were burned.

Likewise, the student radicals joined the strike. Classes were boycotted .... Women-students from exclusively affluent Catholic schools walked out from their classrooms, and joined the drive for funds for the striking transport employees. All told, the strike was a success, and Manila was crippled for over a week.

To date, no accurate statistics are yet available measuring the cost of such a crippling strike in a major business center as Manila in terms of lost working hours, lost wages, lost revenues and sales (businesses in the city reported as much as 75 percent decrease in sales during the strike). Business firms had to use their delivery vans and trucks to ferry their workers to and from work. American companies with financial statement deadlines abroad had to house their employees right in their premises.72

Thus, Kristol criticized the oil industry for not considering the political implications of raising prices during the oil crisis. The companies looked like "profiteers" for their increased profits were extremely painful for the average American, not mentioning the hundreds of thousands of people thrown out of work and threatened with insolvency. See Irving Kristol, "The Corporation and the Dinosaur," The Wall Street Journal, February 14, 1974, p. 14; "The Corporation: A Last Word," The Wall Street Journal, March 14, 1974, p. 16.

72A case paper presented by this writer before a management course on Business and Society at Louisiana State University, November, 1971.
Corporate Social Responsibility in Perspective

To place this concept in its rightful perspective, it is imperative that a further discussion is needed to untangle the basic problems identified with the long-term economic rationale of corporate involvement in social issues proposed in the preceding section. Two other points have to be discussed namely, the planning for social action must be structured, and the fear of stockholder blacklash may not be real as feared; in fact, responsiveness and adaptability to pervasive social demands are characteristics of a good management that could guarantee the company's future profitability.

Long-term profit rationale - The problem with long-term profit as an economic rationale for pursuing social goals is that it is not acceptable to corporate management. Reasons to support it are hard to find; and it one finds a reason, it would be a speculation at best. For one thing, it would not be accurate to claim that corporate management is not planning for their operation tomorrow. Likewise, to assume that management's sole concern is to maximize earnings per share in the short-run to enhance the performance of its stock in the stock market may not be true either. There is a difference, for instance, between contributing money for a global type of training the hard-core than spending money to train a disadvantaged employee of the company. The benefit which the business-man is contemplating from the latter is something concrete; while the benefit from the former is a mere assurance to conscience that the corporate executive has done his part to society. Admittedly, there
are hidden benefits in this case, like improved image, but still the correspondence between cost and benefit is nebulous. Corporate managers are the greatest pragmatists. While their conscience can sustain a nebulous concept, pragmatism which is embedded in their lives would not allow them to. That is why, as Albert Carr observed, "When the directors and managers of a corporation enter the boardroom to debate policy, they park their private consciences outside."\(^73\)

Pragmatism in business appears to be perpetuated by the cost-benefit measurement of the economists. This statement of the late Eli Goldston, President of Eastern Gas and Fuel Associates, and who has written extensively on corporate social responsibility, is indicative of this cost-benefit syndrome: "Quantification is the guts of the problem because if you can't measure it you can't do anything about it."\(^74\)

Perhaps it would be useful, for the purpose of analysis, to define pragmatism in terms of pragmatism per se and pragmatism in conceptual terms. The former has a concrete and definable limits and is neatly related to the cost-benefit relationship of the economists. On the other hand, conceptual pragmatism accepts certain nebulous relationships that only the sensitiveness and

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73 Albert Z. Carr, op. cit., p. 63.

reasonableness of an individual could possibly sustain. Thus, pursuing social goals based on undefined long-term benefit falls under this concept.

Pragmatism per se, reduces the ability of corporate management to accept and to adopt to change. It promotes a myopic and cataractted view of the enterprise's operation. Daniel Bell made this observation, with respect to the reaction of industry to workmen's compensation.

Workmen's compensation was an issue that inflamed a generation of radicals and was fought by industry on the ground that it would relieve the workman of "individual responsibility" for his actions; yet who today would deny that industrial safety is a legitimate cost of factory operations?75

Finally, if pursuing social concerns under the long-term profitability rationale of the enterprise is a domain of conceptual pragmatism, then corporate social responsibility is actually providing an environment in which corporation can prosper.

Structuring an action response program - Corporations which embrace the broadened concept of pragmatism expounded above, and commit themselves to respond to social demands realize that certain organization norms and patterns are disturbed and necessitate revisions and changes. Ackerman of the Harvard Business School identified three of these problems especially in a decentralized corpo-

75 Daniel Bell, op. cit., p. 22.
ration: (1) The separation of corporate and division responsibilities is threatened, because although the division managers are supposed to be autonomous in most aspects of their operation, the company president, as a consequence of his public statements on social responsiveness, may have to interfere in the operation of his field units to insure companywide response to his commitment. (2) The financial reporting system is inadequate and ineffective in measuring social responsiveness. And (3) the executive performance, evaluation, and reward process is challenged due to the fact that in evaluating the performance of subordinates, the basis is not solely on the bottom line, but on a much broader and subtler ways. Yet financial appraisal is paramount in obtaining the subordinates' support in attaining division goals.  

Ackerman cited a division manager's reluctance "to insist on minority hiring and advancement quotas which he felt would introduce new restrictions, ambiguities, and possibly, discord into the process of evaluating his managers."  

Of course, the above is predicated on the premise that minority hiring, for instance, will take a considerable time away from the normal hiring routine or would create serious inefficiencies in the division's operation. This is not the case, however, according to the Employee Relations Office of a participating company in the NACBS Scholar Program. Generally, additional costs were incurred

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77 Ibid.
in searching for prospective minority employees which might involve interviewing at a predominantly minority school or paying an employment agency to search for such minorities. Moreover, a commitment to respond to social causes, or any goal for that matter, involves a total company commitment; from top to bottom in the corporate hierarchy. This is not evident in the company studied by Professor Ackerman. A half-hearted commitment will do harm than good. The initial response of businesses after the riots of the 1960's is a reminiscent of this situation. Says an executive of Standard Oil Company (Indiana): "Looking back over the past five years, my own feeling is that we've been dispensing Band-aids. We've used corporate resources to deal with symptoms of urban problems without really getting to the basic causes."78

The position taken in this writing is that the action and response program of an enterprise should be an integral part of its strategic planning, and shall be a commitment of the total corporation, reinforced by the same standards of goal setting, accountability, performance measurements, and the enforcement of established rewards and penalties. To illustrate the planning process, an overall corporate social planning and decision model is presented in Figure 3.

The inputs to the model may be internal or external or both. The internal inputs may either be (1) the feedback from the

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model itself and/or (2) the results of the analysis and evaluation of current socially-relevant programs of the company. The latter input is the outcome of the special feature of the model, that is, it serves not only as a planning tool but also as a validating device of existing socially-relevant programs of an enterprise. Apparently, a corporation may have various socially-relevant projects being undertaken currently. But not all of them is consistent with the overall social goals of the company; and if it does, a particular program may not meet the criteria for setting up priorities established earlier. Therefore, to promote efficiency in attaining these social goals, each social program shall be evaluated according to its contribution to the accomplishment of such goals. The model provides this evaluation process, and the resulting programs selected become the company's program priorities.

The external inputs are the results of the interaction between the company and society. These are the pervasive social conditions, issues, pressures, preoccupations, etc.

Assuming that an overall corporate social goals has been established and made part of the company's strategic plan, the next step in the model is the formulation of a program profile which starts with the identification of potential social programs as well as developing program criteria (see the program selection guidelines established earlier), consistent with the overall social goals of the company as established in the strategic plan. Consequently, these potential programs have to be screened based on the criteria; define the specific goals and objectives of the specific program(s)
that meet the criteria; identify the existing capabilities -- monetary or personnel -- of the company; match each program with existing and available corporate resources; and finally, select all the specific program which the company is willing to undertake based on the results of the above analysis. Note that the formulation of this program profile may require an interdisciplinary cooperation either among company personnel or between the company staff and qualified consultants.

The next step in the model deals with the implementation followed by setting up a cost profile for each program. The costing (measurement) methodology will be discussed in Chapter V of this study.

The evaluation phase of the model consists of (1) evaluating the efficiency and effectiveness in implementing the program in relation to its specific goals and (2) a strict cost/benefit analysis which focuses on the benefit derived from these programs. As a first step, it would eliminate some of the problems if the phrase "benefits to whom," shall be defined because the benefits of most social programs are readily visible from the standpoint of those intended to be affected such as specific groups or the society at large rather than from the point of view of the corporation. Of course, considering the state of the art, a meaningful evaluation based on a cost/benefit analysis is still not possible. A further evaluation would involve ascertaining the effect of these social programs on the public image of the company. Existing methodologies in the behavioral sciences may be utilized for this purpose.
A growing practice of corporations is to hire a specialist to plan and coordinate its action and response program. The specialist takes a title such as vice-president or director of urban affairs, environmental affairs minority relations, consumer affairs, and others, and generally reports directly to the chief executive. His main job is to plan and implement programs designed to meet the social goals of the enterprise. Although the specialists has the support of the chief executive, he is oftentimes confronted with certain problems with the operating executives of the company. After his study of certain corporations, Ackerman made this observation:

... if staff proposals interfere with its operations, middle management stands aside and let the staff take responsibility (or blame) for the results. Faced with a choice between supporting his senior line executives (who have major operating responsibilities and probably a long history of sound judgments) and his new urban affairs vice-president, the chief executive usually backs up the former.

Unfortunately, these organization problems reduce the effectiveness of the specialist. To minimize these problems, the following points have to be considered. First, the specialist shall assume a strictly staff function; therefore, the implementation of social programs shall not be his responsibility. He merely serves


80 Ackerman, op. cit., p. 93.
as a clearinghouse of the social activities of the enterprise. Second, the line managers shall participate in planning, goal-setting, program evaluation, and the determination of rewards and penalties. Third, the implementation of the socially-relevant projects shall be integrated into the day-to-day operations of the company. This removes the wrong notion among line management that the success of these programs is the responsibility of one man -- the specialist. Finally, the responsiveness of the enterprise towards social issues shall be integrated into the planning process of the corporation. This may involve two main points: (1) requests for capital outlays shall be justified not only in terms of economic considerations but also in terms of their social impact; and (2) the specialist may be allowed to participate in important deliberations concerning investment. Failure to do so may mean future problems and costs to the enterprise.

**Responsibility to stockholders** - One of the foundations of the "classical" view is that the managers are responsible to the owners of the corporations to earn the maximum profit possible. Diverting funds for some other purpose than the making of profit is tantamount to disloyalty and an action innimical to the interest of the owners.

The logic of this argument is based on the historical concept of property rights. Historically, however, it appears that basic to ownership (property rights) is the direct involvement of the owners in the conduct of their property. This setting is no longer true in our modern corporate society. For one thing, the
corporation has been granted by law a juridical personality which is separate and distinct from its owners. For another, the existence of the so-called managers-for-hire makes it convenient for the owners to entrust the conduct of their property to these professional managers. This reduces the owners to just mere suppliers of capital, just like any other creditors of the corporation.

The economist-philosopher Robert Heilbroner made an interesting observation regarding the application of the historical concept of ownership as expounded by Milton Friedman. He said that Friedman's use of ownership is mysterious. Heilbroner added:

I understand exactly what it means when I say I own my typewriter. I don't know at all what it means when I say that I own one ten-millionth of AT & T because I own one share of AT & T stock. Even if I owned one-thousandth of AT & T ... chances are that I would have very little or nothing to say about how AT & T is run.  

McGraw added that the law requires corporate managers to conduct the affairs of the corporation so that returns on capital invested are maximized, but the law does not prohibit certain actions of the managers which may reduce profit to some degree as long as such actions are deemed to be in the best long-range interest of the corporation.  

The fear of shareholder complaints is likewise dismissed

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as a myth. John R. Bunting, President of First Pennsylvania Corporation, a bank holding company, maintains that "shareholders do not seem to react adversely to aggressive corporate social policies." Baum and Stiles attested to this assertion. In their study of the investment patterns of institutional investors, they found that support for management seems to be always assured because this group of investors which they call "silent partners" follow the so-called Wall Street Rule which says "when we buy into a corporation we buy management. We, therefore, support management as long as we are in a corporation. If we don't like management, we sell." 84

On the contrary, the environmental forces which compel the corporation to behave responsibly are very real indeed. While the Sierra Club lost in its attempt to represent the public against the development of an area into a ski resort and summer recreation center, a dissenting opinion by Supreme Court Justice W. O. Douglas opens a new horizon for conservationists. Known as the Douglas theory, the dissenting opinion proposed the enactment of a federal law allowing environmental issues to be litigated "in the name of the inanimate object about to be despoiled, defaced or invaded" where


such a threat is the "subject of public outrage."  

Recently, a group at the Yale Law School proposed that the anti-trust division of the Justice Department should prevent, by legal action, the large automakers from introducing substantial model changes because this constitutes unfair competition and promotes monopolistic imperfections of markets.

Broader significance of corporate social responsibility -
A hard look into the much broader implication of corporate social responsibility cannot be ignored. Social scientists and business observers are in agreement that capitalism and our economic system are still evolving. Theodore Cross, the editor of Business and Society Review, for instance, maintains that "capitalism is an evolving economic system that has been and must be able to respond to changing times."  

Daniel P. Maynihan agrees with Cross, and adds that "corporate responsibility is a device where modern liberalism is seeking to save capitalism from itself."

Finally, it could be contended that the concept of corporate

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88 As quoted by Donald E. Schwartz, "Reforming the Corporation from Within," Business and Society Review, No. 1 (Spring, 1972), pp. 65-66.
Social responsibility is a vehicle provided by society for the modern corporation to justify itself as a social institution. Likewise, it is a vehicle provided for corporate managers to perpetuate themselves as well as to validate the so-called illegitimate powers they possess. Unquestionably, pragmatism in business dictates that this opportunity cannot be ignored by both the corporation and its managers.

Summary

Articulated in this section is the social significance of the modern corporation. Its legalistic abstract existence has been moved to something real, built around its vast economic and political power. As a social institution, the corporation exists not as a random process, but to serve a specific purpose.

The role of the modern corporation is just a microcosm of the larger role which business as a whole is expected to assume. This role is the subject of a raging controversy under the catchall of "corporate social responsibility." Two schools of thought surfaced in this controversy: the social responsibility creed or the "managerial" view recognizes the role of business in attaining social goals, and the free enterprise creed or the "classical" view which holds that the business of business is profits.

While the concept of corporate social responsibility is being debated upon, most enlightened corporate managers who accepted the responsibility are asking for a definition of the boundaries of this new role thrust to them. This study has accepted the conceptual definition of social responsibility by Keith Davis saying
that the concept refers to the "businessman's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest." Additionally, an operational definition is offered which is formulated around three considerations: first, to define social responsibility in terms of compliance with the law; second, to define the concept in terms of activities over and above the requirements of the law; and third, to define it in terms of any voluntary activities in response either to public pressure or to the sensitivity of management to social issues.

The above considerations have provided an insight into the boundaries of an operational definition of corporate social responsibility but they do not provide a basis for setting up program priorities. Consequently, five guidelines, in their order of importance are offered; the first two are compulsory and the last three are voluntary: (1) social concerns within the firm's area of disturbance; (2) social concerns within the firm's area of operation; (3) social concerns which the firm has the necessary expertise; (4) social concerns not included in (1), (2) and (3) above having an impact on the community where the firm is located; and (5) the same as in (4) above, but the impact is beyond the firm's location.

Based on the various considerations and guidelines discussed above, corporate social responsibility has been defined as referring to the businessman's decisions and actions, voluntary or in compliance with law, without the expectation of direct economic gain, for the well-being of society or for one or more of its constituents. Such decisions and actions are determined by such criteria as (1)
area of disturbance; (2) area of operation; (3) existence of the necessary expertise in the company to do the job; (4) impact on the firm's immediate location; and (5) impact beyond the location of the firm.

A social and economic rationale for corporate social responsibility has been developed. The former is based on the premise that business is a social system and within it are subsystems composed of the corporation, managers, employees, creditors, suppliers, customers and the general public. Consequently, social profiles of the corporation and of the corporate managers have been developed.

The economic rationale for corporate social responsibility is built around the context of short- and long-term profits and profitability of the firm. Conceivably, a tendency to maximize short-run profits may affect the long-run profitability and viability of the company.

Corporate managers are the greatest pragmatists. However, they tend to be preoccupied with the short-run profits. For this reason, pragmatism has been defined in two levels; namely, pragmatism per se, and conceptual pragmatism. The former has concrete and definable limits such as those decisions and actions which promote short-run profits, and is nearly related to the cost-benefit relationship of the economists which has occupied the minds of corporate managers. Conceptual pragmatism, on the other end, allows nebulous relationships beyond the economist's cost-benefit correspondence, such as those decisions and actions which concern with long-run profits.
A half-hearted commitment to involve in social issues will produce more harm than good. Consequently, this study proposes that the action and response program of an enterprise shall be an integral part of the firm's strategic planning, and shall be a commitment of the total corporation. A planning model (Figure 3) is offered for this purpose.

It is becoming a common practice among large corporations to hire a specialists to plan and coordinate their action and response program. The specialist takes a title such as vice-president or director of urban affairs, environmental affairs, minority relations, consumer affairs, etc. and generally reports directly to the chief executive. In this respect, the corporation shall take the following view concerning the function of the specialist as well as the philosophy of the firm's action and response program: (a) he should assume a strictly staff function; (b) the line managers shall be allowed to participate in planning, goal setting, program evaluation, and the determination of rewards and penalties; (c) the implementation function shall be integrated into the day-to-day operation of the company; and (d) the responsiveness of the enterprise towards social issues shall be integrated into the planning process of the corporation. Moreover, the specialist shall be allowed to participate in the deliberations over important investment decisions to articulate social considerations.

The traditional view of property rights which involves a direct involvement of the owner in his property, is one of the foremost foundations of the "classical" thought. However, this setting
no longer exists. In a corporate atmosphere the managers decide what goals to pursue for the corporation; the stockholders are but a part of the myriad of capital contributors to the corporation.

In recent years, class action against corporations which are about to or degrading the environment become a strong weapon by environmentalists. Of course, there were setbacks. However, in one of these setbacks, Supreme Court Justice W. O. Douglas, in giving his dissenting opinion, proposed a way or protecting the environment. Known as the Douglas theory, Justice Douglas proposed the enactment of a federal law allowing environmental issues to be litigated in the name of the inanimate object about to be despoiled, defaced or invaded, where such a threat is the subject of public outcry.

A much broader implication of corporate social responsibility has been threshed out. Social scientists and business observers believe that capitalism and our economic system are still evolving.

The next section will discuss the economic implication of corporate social responsibility.

III. THE ECONOMIC ASPECTS OF CORPORATE SOCIAL RESPONSIBILITY

The preceding section has discussed the relevant issues of corporate social responsibility. Emphasized in the discussion is that the concept questions the profit motive as the dominant driving force of the business enterprise. In brief, the social responsibility advocates propose that the modern corporation should think beyond profits, and that involvement in social issues is part of the enterprise's responsibility in our modern society.
Unfortunately, this proposal runs counter to the basic economic concept which perceives the modern corporation as an economic unit, pursuing the fundamental purpose of business in a capitalistic society -- to earn the highest possible profit for the providers of capital. Of particular issue which involves significant economic ramification is the problem of environmental pollution and degradation. Not only that the problem requires the commitment of enormous economic resources, but it also questions certain fundamental assumptions of the economic enterprise.

Therefore, this section will discuss certain significant economic implications of corporate social responsibility as it relates to the issues of environmental pollution and degradation. Emphasis shall be given as to how social costs shall be internalized, and accounted for in the decision model of a business unit.

**Meaning of Ecology**

A discussion of environmental problems is generally addressed to a broader system known as ecology. Defined as the "study of the relationships or interdependencies between living organisms and their environment to see how they function together in their ecosystem." ecology is therefore a systems approach to nature -- a science which attempts to describe and analyze the so-called "household of nature."\(^{89}\) The interacting elements in the

ecosystem are both living and non-living organisms: (1) non-living or inorganic matter (like sunlight, carbon dioxide, water and minerals); (2) producer plants (like lower organisms and green plants); (3) animal consumers (generally higher organisms like animals and man); and (4) decomposers (non-green organisms like bacteria and fungi). 90

The interaction of these elements (which is basically growth and decay). results in an ecological balance in the ecosystem. Without this interaction, the world will be littered, and eventually filled up with dead organisms. However, the assimilative capacity of the environment has a limit, and our existing problems of pollution is a manifestation that the limit has been reached.

Ecology is still in its infancy. Very little is known about the structure or function of nature as well as the part mankind plays in it. 91

Boulding summarizes the existing knowledge in this manner:

... the main thing I have learned in regard to environmental problems is the relative backwardness of the physical and biological sciences. It is frequently our ignorance of the physics and chemistry of the atmosphere

90 Ibid.

91 The literature on ecology has been increasing in recent years. Writings on the subject are found in technical journals such as in agriculture, forestry, biology, and in the other hard sciences. A few publications that deal on topics related to ecology are Land Economics, Journal of Farm Economics, Natural Resources Journal, The American Economic Review, Journal of Political Economics, Quarterly Journal of Economics, etc.
or of the biology of large ecosystems which holds us up on the practical side of environmental improvement.\textsuperscript{92}

Dr. David Gates, Director of Missouri Botanical Garden in St. Louis put the matter in a more dramatic way:

We are in danger of going down in history as an elegant technological society that was struck down for lack of ecological understanding. \textsuperscript{93}

\textbf{Cost of Economic Activity}

Production and consumption are economic activities which economic theory has dealt with for ages. But the major concern of the economics discipline is production which supports the maximization of the profit function of an enterprise thereby exerting the pressure to maximize outputs and minimize the inputs. Additionally, to create a wholesome balance -- essentially, the allocation of resources -- among the participants of these activities, the economists rely on the workings of the marketplace. Unfortunately, the competitive marketplace which the economist conceived is a utopian view of the real world for imperfections are the rule rather than the exception. \textsuperscript{94}


\textsuperscript{93} "A New Science Tries to Keep Old Balance," \textit{Business Week}, November 15, 1969, p. 68.

The economists model of production accounts for almost exclusively the historically accepted factors of production -- land, labor and capital -- which are now generally aggregated under the term private costs, or as Barry Commoner describes it, "conventional capital." Excluded from this model are the free goods, like air and water, which are essential in the production activities of the enterprise. The use of these free goods or as Commoner calls it, "biological capital," results in unaccounted for and uncompensated costs known as social costs.

To be highlighted in the following paragraphs are certain aspects of private and social costs. Detailed discussions on these subjects are numerous, particularly in the publications enumerated in an earlier footnote of this section.

Private Costs

Private costs are costs which are internal to the firm, and are measurable in terms of the costs of resources consumed or destroyed, and borne by the enterprise in its operation. These consist of raw materials, labor, overhead, operating expenses and other costs which are recognized in the decision models of the enterprise. Unfortunately these private costs are not sufficient to complete the production process of the firm because certain "free


96 Ibid.
goods" or "biological capital" are needed. In fact as Commoner argues, private costs or "conventional capital," to be useful have to depend on the existence of the "biological capital." If the latter is destroyed, the usefulness of the former is also destroyed. 97

In maximizing profits, only the conventional capital is considered because of the built-in tendency of the decision-making process to disregard those factors which are external to the decision-making unit. In effect, managers of business enterprises are making decisions based on an incomplete data. Evidently, this situation creates a misleading or illusory index of efficiency among business units. The reason is that certain activities such as strip mining, paper manufacturing, petroleum refining, etc., use a greater amount of biological capital than the others. Conceivably, certain activities which may appear profitable from a private cost point of view may look undesirable profitwise when all such costs are included. In addition, since all the costs of production are not accounted for, products sold in the market are underpriced, and ultimately, would stimulate consumption.

Commoner maintains that the use of biological capital which is excluded in the cost structure of a business unit constitutes a borrowing from the ecosystem, and therefore incurs a "debt to nature." Since this "debt" is not subsequently paid for, it represents "an immediate saving for the producer." 98

97 Ibid., p. 50. 98 Ibid.
Social Costs

Unfortunately, the savings realized by the producer, constitute a desaving from society's point of view. The unaccounted for biological capital consumed or destroyed in the productive process are transferred to society in the form of disamenities such as air and water pollution, reduction in the aesthetic value of the landscape, damages to human health, or in general, environmental degradation. These disamenities are known as social costs, "bads," disproducts, disutilities, or spillovers.

Collier defined social costs or disproducts as "negative services generated by the same processes which create products." This encompasses all direct and indirect losses suffered by third persons or the general public as a result of private economic activities. K.W. Kapp suggests that social cost includes even certain "social opportunity costs," that is, those social cost elements which take the form of wastes for inefficiencies of various kinds.

A broader concept than social cost is the so-called externalities which encompass not only the disamenities (or social costs), but also the amenities (social good, external economics, external utilities, etc.) The matter of externalities was raised

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in 1859 by John Stuart Mill when he distinguished between "regarding and other-regarding actions" and proposed that only the latter were subject to the jurisdiction of society.101 The concept was again raised by Alfred Marshall sometime in 1890. He indicated that economists should be concerned with forces outside conventional economic activities. But the externalities raised by Marshall were mostly positive.102 Later, A. C. Pigou thought, as he watched the smoke from an English factory, that there could be negative externalities as well. This idea was the subject of Part II of Pigou's book, The Economics of Welfare, and since that time the concept of externality dominates theoretical welfare economics.103

Internalizing Social Costs

Social costs are considered as a social subsidy since industry does not pay for them. Although they are considered as inherent


in the production and consumption processes, the desirability of eliminating them is manifest. But total elimination of these social costs appear to be a fantasy for people and businesses, according to economist Sanford Rose, "do not consume goods; they extract utilities from goods before discarding them.104

The problem with social costs is that their unfavorable consequence create a misallocation of resources, for the unconscious acceptance by society of these economies makes it profitable for the perpetrators to create them. Moreover, no incentive to eliminate these disamenities could be expected unless they affect the operation of a business unit. Therefore, in order to create this incentive, it is necessary to internalize them so that concern for these bad effects could be stimulated.

However, the task is a complex matter which has been debated upon by economists for a considerable length of time. Evidently, agreement seems to be elusive, for the debate still occupies a dominant aspect of welfare economics. This appears to be a compelling reason to look at the suggested approaches for internalizing social costs

The methods of internalizing diseconomies can be grouped into three general propositions, voluntary action by industry, government action or a combination of both.

Voluntary action by industry - A unilateral action by industry is a basic proposition of the corporate social responsibility advocates.

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104 Sanford Rose, "The Economics of Environmental Quality," Fortune, Vol. LXXXI (February, 1970), p. 120.
Obviously, this proposition could be stimulated by certain incentives such as tax credits and/or accelerated depreciation for the purchase and installation of control equipment. These types of incentives are being used by the federal and state governments on a very limited basis for air and water pollution abatement.

Mishan advocates a voluntary relocation of industries to areas where spillovers would be less costly. This would result in the inclusion of the cost of disamenities in the ordinary location theory which encompasses such customary considerations as transportation, access to raw materials, labor, specialized services, etc. An analysis of these factors may uncover that it would be cheaper for the company to operate somewhere else than in its present location.105

Government action - While most would frown at the idea of government intervention, economists tend to favor the imposition of a fee or a tax, particularly on pollution problems based on the amount of pollutants emitted into the air or water. Professor Ralph Estes cited several indicators towards acceptance of this approach built around the Pigovian tax system.106 A. C. Pigou proposes a system of rewards for external economies, and penalties (tax) for external dis-economies.107


107Pigou, op. cit., p. 192.
Turvey expressed certain reservation to the Pigovian tax system to the effect that "the imposition of a tax upon the party imposing external diseconomies can be a very complicated matter, even in principle, so that a priori prescription of such a tax is unwise." He supports his contention on the analysis of marginal social and marginal private product, and contends that in the case of emitting smoke with a choice between a tall and a short chimney, a tax system will not result in an optimal allocation of resources since chimney heights must also be regulated. Turvey added, however, that such tax would be good if based on losses imposed and not on the effluent discharged. He posited the idea that if the party imposing the disamenities and the party affected are willing to negotiate to their mutual advantage, state intervention is unnecessary to secure optimum resource allocation.

Wellisz agrees in principle with the Pigovian tax system but he expresses certain reservation because of the difficulty of applying it, let alone its resulting inaccuracy. He nevertheless suggests that it will be worth the time of the economists to design the best available Pigovian tax system instead of "making indignant noises when the policy makers adopt silly measures for want of expert advice." Consequently, Wellisz dismissed Turvey's proposal for

108 Turvey, op. cit., p. 309.  
109 ibid., p. 312.  
110 ibid., p. 309.  
112 ibid., p. 354.
negotiated settlement between the offending and the offended parties as "a universal panacea and applicable only on exceptional cases."\textsuperscript{113}

Plott took issue on the tax proposal, and argues that the tax be imposed either (1) on the quantity of harmful element produced by the offender or (2) on the resource input from which damaging element is generated.\textsuperscript{114} Friedman favors the first basis offered by Plott if the costs imposed on people can be determined.\textsuperscript{115} Finally, Mishan took a more general approach by advocating the inaction of "spillover repressive law that encompass a wide range of specific spillovers."\textsuperscript{116} The essence of the law is the recognition of the rights of the citizens and the transfer of the burden of proof and of costs, on the offending party.\textsuperscript{117}

Gerhardt expounded the idea of award payments geared to the percentage reduction from the total potential emissions to an absolute reduction in terms of certain amounts of pollutants, or to the attainment of an emission standard set by government regulation.\textsuperscript{118}

\textsuperscript{113}Ibid.


\textsuperscript{115}McCloughry, "Milton Friedman Responds," \textit{op. cit.}, p. 10.

\textsuperscript{116}McCloughry, "The Apostle of Anti-Growth ....," \textit{op. cit.}, p. 6.

\textsuperscript{117}Ibid.

\textsuperscript{118}Paul H. Gerhardt, "Incentives to Air Pollution Control," \textit{Law and Contemporary Problems}, Vol. XXXIII (Spring, 1968), p. 360.
Voluntary industry - government action - Under this approach, the government is supposed to set standards for the offending industries to meet. Gerhardt suggests that if the standards are exceeded, the particular firm shall receive a certain amount of payment to offset the cost of control outlays. However, if the standard is not met, a charge (tax) shall be imposed, high enough to make continuous offense unprofitable. Moreover, business executives appear to favor this type of intervention from the government. In a Yankelovich survey of Fortune 500 companies, 57 percent of the 270 top executives interviewed favored a step up regulation on air and water pollution control.

Evaluation of Alternatives

There are certain objections to government action. First, a complex system of regulations, licensing, taxation and monitoring would be needed which "violate the free enterprise spirit and add new constraints to the free exchange that is supposed to make the market system work." Second, the tax proposal is somewhat akin to the so-called "bathtub argument" which is primarily an action-reaction type of solution. This means that as an enterprise pollutes, society cleans resulting in either a status-quo or an aggravation of current pollution. And as the offender maximize its profits, pollution may

119 Ibid.


121 Commoner, op. cit., p. 46.
increase or decrease with the corresponding increase or decrease in
the tax money. This may result in a smaller pattern for the pollution
abatement activity. This "locked in" relationship may be broken up if
there is an efficiency in the abatement procedures which may either be
in the activity itself or in the technology as manifested by the equip­
ment in use. Either way, inefficiency will be a problem not mentioning
the slow development in the abatement technology because the motivation,
expertise, and talents of industry would not be utilized to bear on
the problem. Third, there exists a moral issue that the economic
power of the offenders is effectively utilized to buy out a wrongdoing.
Additionally, as Commoner points out, some producers might be willing
"to buy the right to pollute by paying a tax, and then damage the
environment in ways that no taxes can repair."122 Finally, it appears
that the tax promotes and intensifies the misallocation of resources
in the sense that the responsibility for preventing the firm's pollu­
tion is transferred to somebody else; the control of which could
have been economically and efficiently done at source. This point
could be compared with the problem of defective cars which the auto­
mobile manufacturers transfer the responsibility of servicing to the
repair shops. This creates a misallocation of resources because the
defective cars could have been avoided by perhaps, strengthening the
quality control.

Controlling pollution at source may be more efficient and
effective and this could be done voluntarily by the offender. The

122 Ibid.
reason is obvious. As they maximize their profits, the offenders will have the motivation to search for better ways of handling the problem. This situation may enhance considerably the pollution control technology. Consequently, pollution abatement at source may be more effective with the existence of reasonably determined standards set by the government.

Award payments have their own serious drawbacks. A former businessman made an interesting point in this regard:

True, if you would base pollution control on a system of incentives, you might be disappointed. The marginal dollar gained for pollution control is hardly as exciting as the marginal dollar gained in expanding sales, creating new products or improving technology. This type of income promises growth and future profits. I think that many, if not most businessmen, have a shortage of key personnel and they would rather use this resource to develop the mainspring of their profits than to maximize the pollution subsidies.¹²³

In considering the above problems of these various approaches, this study believes that the internalization of social cost could be done effectively and efficiently through industry and government cooperation. This means that industry has to voluntarily meet, on the minimum, the guidelines or standards set by the government in return for certain incentives such as those mentioned above.

Social Cost in Perspective

There are two related issues which will be underscored in

this discussion: (1) the growing controversy on growth and productivity between economists and environmentalists, and (2) the "either-or" direction and substance of this controversy.

The two sides of growth and productivity - John K. Galbraith\textsuperscript{124} fomented the widening controversy over growth and productivity particularly between the environmentalists and economists.\textsuperscript{125} The former contends that the price tag of increasing production and consumption are the degradation of the environment and the increasing disamenities of life. Several studies attempted to prove this point. K. William Kapp found in his study of the social costs of private enterprise that the maximization of not income by microeconomic units was likely to reduce the income of society as a whole\textsuperscript{126} In 1971, Jay Forrester published the result of his world scale computer model which provided for the interaction over time of population growth, food supply, capital investment, geographical space, pollution and resource depletion. His conclusion corroborated Kapp's findings to the effect that the optimization of any sub-systems will generally conflict with the well-being of the large system of which it is a part.\textsuperscript{127} In 1972, Forrester's colleagues at Massachusetts Institute of Technology came up a sophisticated computer model which predicted the collapse of the

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{124}Galbraith, \textit{op. cit.}
\item \textsuperscript{125}For an excellent discussion of the key points in this controversy, see Henderson, \textit{loc. cit.}
\item \textsuperscript{126}Kapp, \textit{op. cit.}
\item \textsuperscript{127}Jay W. Forrester, \textit{World Dynamics} (Cambridge, Massachusetts: Wright Allen Press, 1971)
\end{enumerate}
\end{footnotesize}
earth's resources by mid-21st century. 128

Commoner indicated that the point is not to suggest the rule that increased profitability inevitably means increased pollution or other disamenities, but only that many heavily polluting new technologies that displaced old ones since the last world war, have resulted in higher rate of productivity and profits. 129 Therefore, the continued maximization of productivity would result in increased disamenities of life. Commoner goes to suggest that with high pollution and high productivity, perhaps, the whole system would not be productive. The reason is that to rectify the effects of these disamenities would require tremendous resources. 130

E. J. Mishan, the so-called apostle of anti-growth, agrees with Commoner. He argues that as progress is "being unrolled by the foot, it is simultaneously being rolled up behind us by the yard." 131

The former Secretary of Interior, Stewart L. Udall, adds:

We have treated all growth as beneficial, and we've assumed [that we could take care of all its demands. But now, so many questions are raised by growth that we have to question its assumptions and eventually contain it. 132

128 Meadows, et al., op. cit.

129 Commoner, op. cit., p. 49.

130 Ibid., p. 50.


On the other hand, the economists are not impressed by the evidence presented by their adversaries. They discounted these studies as new Malthusian scares, and reiterated the benefits of growth and productivity in terms of wealth and income distribution. As a rebuttal to the evidence gathered by the various studies cited above, such economists as Henry Wallich and Walter Heller raised technology as their prime mover.133

More interesting than the controversy itself and the arguments of both sides, are the direction and the substance upon which the disagreement is moving. For both camps, the traces of the "either-or" arguments are evident.

"Either-or" direction and substance of the controversy - An interesting but disturbing aspect of the controversy is the extreme choices which are implicit in the arguments of both camps. The environmentalists, while not making their position clear, have been talking about zero pollution as well as bringing class action against development plans of potential disturbance to the environment. In fact, the environmentalists were blamed to some extent for the inability to develop the Alaskan North Slope which, to some degree, has contributed to the energy crisis.

On the other hand, the economists are more explicit in their choice criterion -- marginal cost versus marginal benefit -- articulates the "either-or" substance of this argument. For instance, Friedman does not believe on zero pollution or zero accident if the cost of attaining

133Henderson, op. cit.
them exceeds the cost of paying for accidents or pollution. On the choice between polluting the water or keeping the fish, the determining factor is whether the value of the fish lost is greater or less than the value of the product produced which makes the contamination of the water possible. Consequently, as between productivity, growth and profits on the one hand, and the removal or prevention of the disamenities on the other, the choice, based on the economists' criterion, is obviously the former.

But the logic of these choices is open to serious question for the undesirable effects on the quality of the environment is not a theoretical danger; rather a real one indeed. Evidently, the most desirable choice is to harmonize productivity, growth and profits with the quality of the environment in recognition of the fact that the enhancement of the quality of life requires both economic and environmental amenities. McGuire call this a "both-together" approach, while Boulding expresses it philosophically: "Is eating a good thing or is it being well fed?" For him being well fed is more important than eating. Of course, eating and being well fed has to go together.

134McIaughry, "Milton Friedman ...," op. cit., p. 10.
135Coase, op. cit., p. 2.
136McGuire, op. cit., p. 147.
Summary

This section has discussed the significant economic implications of corporate social responsibility as they relate to the issues of environmental pollution and degradation.

Apparently, a discussion of environmental problems is generally addressed to a broader system known as ecology. Ecology has been defined as the study of the relationships between living organisms and their environment. To date, however, little has been known about the structure or function of nature.

In the production activities of a business unit, both private cost (or conventional capital), and social cost (or biological capital) are incurred. However, only private costs are accounted for in the production model of the enterprise. Therefore, a business unit is making decisions based on an incomplete data.

Private cost consists of the costs of resources consumed or destroyed and borne by the enterprise in its operation. It includes raw materials, labor, overhead, and other costs. Social costs or "disproducts" are negative services generated by the same processes which create products. These costs consist of all direct and indirect losses suffered by third persons or the general public as a result of a private activity. Social costs also include social opportunity costs, that is, those social cost elements which take the form of wastes or inefficiencies of various kinds.

The exclusion of social cost from the firm's decision model causes an illusory index of efficiency and profitability among business units. Obviously, certain activities which are profitable from the
private cost point of view may be undesirable from a social cost standpoint, or vice-versa. Likewise, the inability to account for social cost constitutes a saving for the producer. Unfortunately, this becomes a desaving from society's standpoint in the form of bad effects or undesirable consequences from the disamenities such as air and water pollution, environmental degradation, illness and other health effects, etc.

A broader concept than social cost is known as externalities which encompass not only the bad effects or disamenities but also the good effects or amenities. The bad effects are considered as a social subsidy to industry.

To eliminate completely social cost may be an impossible goal, however, it could be minimized if social cost could be internalized or introduced into the decision model of the enterprise. Three methods are proposed: (1) voluntary action by industry which could be stimulated by such incentives as tax credits and/or accelerated write-offs of the costs of, say, pollution control equipment; (2) government action, in the form of direct taxation or fee based on the effluent emitted or disposed; (3) voluntary industry-government action. Under this approach, the government sets up standards which the offending industry or firms have to comply.

Government action appears to be the least desirable because of the various objections cited in the study: (1) government intervention creates a complex system of regulations, licensing, taxation, and monitoring which violates the free exchange that makes the market
system work; (2) the tax proposal is similar to the so-called "bath-tub argument" which may either aggravates the problem or promotes a status-quo; (3) this approach underscores a moral issue that the economic power of the offenders are used to buy a right of wrongdoing; and (4) the solution aggravates the misallocation of resources by transferring to an outsider the control of pollution which could be done more effectively and efficiently at source.

Another system of incentives in the form of award payments was discussed and their drawbacks were identified. It is the position of this study that the internalization of social costs could be done effectively through the cooperation of industry and government. Industry is expected to voluntarily meet, as a minimum, the standards or guidelines set by the government in return for certain incentives such as those discussed in this study.

A raging controversy exists between the environmentalists and the economists over continuous growth and maximization of productivity and profits. The former has provided coherent and convincing evidence to the effect that continuous growth and productivity and a single-minded drive for maximum profits have serious consequences. The economists, on the other hand, argues that growth and productivity are needed for a greater distribution of wealth and income.

Noted in this section is the "either-or" substance and direction of the controversy. This study proposes a harmonizing approach -- "both-together" -- in dealing with the environment and the economic motivation of the firm. The proposal is premised on the idea
that the quality of the environment as well as continued growth, productivity, and profits are essential to the enhancement of the quality of life.

The next chapter will discuss the significance and the challenge of corporate social responsibility to the accounting profession.
CHAPTER III

CORPORATE SOCIAL RESPONSIBILITY: AN ACCOUNTING CHALLENGE

The discussion of the dynamic relationships between society and the modern corporation as manifested by the so-called corporate social responsibility and depicted in Figure 1 has been completed in Chapter II. This chapter will deal with the social role of the accounting profession resulting from its intimate relationships with the corporation on the one hand and its interface with society on the other (see Figure 1). The discussion will provide a brief review of the traditional role of the accounting profession and the conflicting views regarding the expanded social role of the accountants. Conse-

quently, a definition of the profession's social responsibility will be offered which will provide a basis for setting up a social profile for the accountants and the accounting profession. Also, a framework for broadening the social role of the accountants will be discussed.

The Social Responsibility of the Accounting Profession

The so-called social responsibility is not new in the accounting profession. The concept has always been a part of the profession because of its unique responsibility in the conduct of its trade. The accountant's concern is service to his clients according to the highest ideals and standards of his trade, but such responsibility is subordinated to his obligation to the public.

In the past, the fulfillment of the profession's social responsibility has been done indirectly. John Lawler summarizes this indirect social contribution of the accountant:

In their day-to-day practices, CPAs are already making a substantial contribution to the economic well-being of the country. They do so whenever they aid a small business enterprise to survive in the vigorous competition of the marketplace -- whenever they facilitate the flow of venture capital by adding credibility to financial statements; whenever they provide assurances that funds advanced by others are being properly utilized; whenever they render management advice which results in lower costs or higher profits; whenever they assist taxpayers to pay no more (but no less) than their fair share of the nation's tax bill.2

The recent accent on corporate social responsibility has stimulated a transformation of the profession's role from an indirect

or passive to a direct or active participation or involvement in social issues. These include aid to small business, recruiting minorities, education of minorities, developing measurements for social programs, environmental concerns and problems of cities.³

This new role is inevitable. The strategic location of the accounting profession between the society and the modern corporation as well as the recent concern for the fulfillment of social goals makes it susceptible to absorb the changes that occur in the interaction among the corporate participants, and the society as a whole.

However, this direct role of the accounting profession is subject to an existing controversy among accountants. The conflict will be discussed in the following paragraphs.

Conflicting Views of the Accountant's Social Responsibility

There are two conflicting views regarding the social responsibility of the accounting profession. Identified in this study as the "classical" view, the first group found a well-respected spokesman, Professor William A. Paton. For him:

... the notion that the goal of the professional accountant is public or social service is nonsense. His function is to his specific clients; the people who pay for his efforts.⁴

In addition, Professor Paton does not believe that the accounting profession should accept the responsibility for measuring the cost of air and water pollution. He argues that he would "like to view accounting in fairly broad terms, but we can't cover the waterfront ...."^5

The "enlightened" view is shared by the majority of the accountants. David F. Linowes has been the leader of this group. He argues that accountants have to "speak out with dignity and force; take public stand on vital issues of the day -- especially in those matters in which our expertise makes us uniquely qualified."^6 Bowen found this attitude to be pervasive. She concludes that her study supports the determination that the accounting profession is willing to accept a broadened social role, and that the accountants are becoming increasingly involved with the social problems of the American society.^7

Meaning of the Accountant's Social Responsibility

Perhaps, the ensuing controversy as to the social responsi-

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^7Bowen, op. cit., p. xii.
bility of the accountants results from the absence of a conceptual and/or operational definition of the concept. Even Bowen's comprehensive study of the attitudes of the accounting profession towards social responsibility does not provide such a meaningful definition.\(^8\)

A conceptual and philosophical definition of the accountant's social responsibility may be stated as encompassing those actions and actuations of the profession which directly or indirectly intended to perpetuate itself. To attain its economic motive, the accounting profession has to serve its clients well. Similarly, to maintain its social status and acceptance and to justify its existence, the accounting profession has to be responsive to the needs of society. Obviously, these dual aspects of the profession's behavior are not mutually exclusive. The absence of one aspect would mean a critical diminution of its importance. Moreover, these are part of a number of determinants which separate a profession from a mere occupation or trade.\(^9\)

\(^{8}\)Bowen defined social responsibility as "to denote a broad obligation to the community and an additional obligation to nurture and develop human values which cannot be measured in economic terms. This type of responsibility arises from a concern for the ethical consequences of one's actions as they might affect the interests of others" Bowen, op. cit., p. 11.

The philosophical aspect of the definition assumes that the primary loyalty and responsibility of the accountant are to his profession. If such degree of loyalty and responsibility is achieved, and is believed to be achievable, the well-being and the future of the accounting profession is secured. Loyalty and responsibility to the profession require its perpetuation, and this condition can only be met by working through the dual aspects of the profession's behavior identified above as (1) service to clients and (2) responsiveness to the current needs of society. Deductively, therefore, loyalty and responsibility to the accounting profession achieves its perpetuation, by securing its future and well-being through the highest standard of service to clients and responsiveness to society's needs.

Professor Paton attempted to combine a conceptual and philosophical definition of the profession's social responsibility when he said that the best way for the accountant to achieve the goal of public or social responsibility is to serve his "client, patron, customer, or anyone else he is working for as well as possibly can in the light of his training and experience." But his concept pertains to the traditional service profile of the accountants. While the economic motive is satisfied through excellent service to clients, patrons, customers, etc., as referred to by Professor Paton, the social contribution of the profession is manifested indirectly.

10Paton to Fertig and Beams, loc. cit.
Apparently, this indirect service profile of the accountants is no longer acceptable to society. Where social goals are moving rapidly to the periphery of social concerns, direct and overt involvement of every institution, including the accounting profession is paramount.

Linowes provides an operational definition of the profession's social responsibility. He proposes three levels of responsibility:

-- The social responsibility of our profession to perform well its traditional assignments for those it serves -- its clients.

-- The responsibility of each discipline to prove new frontiers and expand the parameters of its work, to help contribute to a better society.

-- The social responsibility of any educated group of citizens to its nation and society.11

The first level pertains to the satisfaction of the profession's economic motive through service to its clients, while the second and third levels are concerned with the social dimension of the accountant's social responsibility. While the definition does not specify the degree of involvement implicit in the last two levels, flexible inference could be drawn as to their horizon. In fact, it is from these two levels that Linowes challenges the accountants to act.

Social Profile of the Accountants and the Accounting Profession

To reinforce the case for a direct involvement of the accounting profession in social issues, it is imperative that the social status of the profession is understood. This understanding

11Linowes, op. cit., p. 76.
could be enhanced by setting up a social profile of the (1) accounting profession and (2) the accountant as a professional and as a member of society.

Social profile of the accounting profession - The third level of responsibility identified by Linowes above, concerns with the responsibility of "any educated group of citizens to its nation and society." This proposition is inherent in any profession. Institutions (professions, for that matter), are part of a social process, and therefore, they are a creation of society. Society created them to serve a purpose -- to satisfy its needs. In the event that such institutions faltered in their missions, and according to the purpose of their creation, their existence will be indefensible and unjustifiable. Then, by the same process that created them, new institutions will appear to replace the worthless and unresponsive ones.

MacNeill agrees with this proposition. He maintains that "the effective functioning and existence of the profession is determined, by and large, by the wishes of the period or time."  

12 Ibid.

13 Institution is defined by Professor Hubbard "as the embodiment of concepts, assumptions, and principles based on social postulates of acceptable behavior and established for the purpose of performing certain essential social functions." Thomas Hubbard, "A Social Foundation for Accounting Theory," DR Scott Memorial Lectures Volume V (Columbia, Missouri: The University of Missouri, Columbia, 1973), p. 7.

Hubbard emphasizes production and distribution of goods and services to all the conundrum of business through the free enterprise system as the primary source of the profession's function.\textsuperscript{15}

\textbf{Social profile of the professional accountant} - It would seem logical that the social profile of the professional accountant is a matter of restating the code of ethics of the profession. The Code of Professional Ethics of the American Institute of Certified Public Accountants notes the following points:

The reliance of the public, the government and the business community on sound financial reporting and advice on business affairs, and the importance of these matters to the economic and social aspects of life impose particular obligations on certified public accountants.\textsuperscript{16}

The obligation, according to Hubbard, requires the accountants to relate to modern society if they are going to retain their positions in the social scheme.\textsuperscript{17} Quoting the \underline{Canadian Chartered Accountant}, Gerald Ross underscored this obligation in another light:

\... Good accountancy is the beginnings of business justice, and business justice, fairness in the transaction of business, is a very important factor in social and economic justice.\textsuperscript{18}

Louis Goldberg expounded on three areas of accounting

\begin{itemize}
\item Hubbard, \textit{op. cit.}, p. 9.
\item Hubbard, \textit{op. cit.}, p. 4.
\end{itemize}
interest to which accountants may apply themselves at each level of government. He described one of these levels as follows:

...it would appear, at least on the face of things, that accountants are or ought to be the people in the community who, by their training and interests, are best fitted to be the intelligent and knowledgeable critics of a government's management of the resources entrusted to it in so far as this is revealed by accounting and financial information. They are in a position, especially in a democracy, to exercise a wholesome function as constructive critics of the ways in which the government is carrying on its affairs, particularly in their economic and financial aspects...19

This is the reason why observers outside the profession call upon the accountants to assert their social importance. John L. Cobbs, editor of the business section of Business Week, challenged the accountants by saying:

...For your own protection, you must become missionaries--even if that means that once in a while you have to take the chance of being eaten by the natives.20

Ralph Nader asked the accountants to assert their influence on their clients to do away with irresponsible acts, realizing however, that "this can be a prescription for martyrdom."21 Roy and MacNeill added that the accountant must sometimes take a firm stand, even when to do so is to bite the hand that feeds him." In concluding this obser-

19Ibid., p. 19.


vation, they paraphrased Voltaire in saying: "If the CPA did not exist, it would be necessary to invent him."22

Social profile of the accountant as a member of society - As a member of society, the accountant, apart from his responsibility to follow the laws of the land, is expected to play an important role in community affairs especially in areas where his expertise is needed. A community organization, for example, may function well because of the financial advice of the accountant.

On the other hand, the accountant has his own aspiration for himself and for his family. Whatever he does in his professional life redounds to the benefit of society for which he is a member. He deserves a wholesome and peaceful environment, clean air and water, an efficient public services, and so forth.

Broadening the Accountant's Social Responsibility

The social responsibility of the accounting profession discussed previously, needs a critical examination and a broad conceptual interpretation to enhance the responsiveness of the profession to the changing needs of society. To attain this objective, Bedford proposes that a basic conception of society is needed to determine a desirable future role for accounting as a subsystem of society.23 Hubbard suggests the formulation of social postulates -- social concepts of

22Roy and MacNeill, op. cit., p. 32.

acceptable behavior -- to serve as the basic conception for the under­
lying rules governing social action. He proposes that the "accounting
concepts of behavior or postulates are subordinate to social postu­
lates." 24

An approach to the formulation of such basic conceptions or
postulates is through a coordinated analysis and understanding of
changing social patterns, modes, customs, values, etc. This is in
recognition of the fact that the desire of society govern the actions
of all groups or institutions functioning within society. In effect,
a behavior which is inconsistent with the desires of society has to be
either abandoned or modified. Moreover, the whole process will result
in seeking and identifying the needs of society rather than having
society seeks out what the profession can offer. These postulates
shall be the basis for a socially-oriented accounting philosophy
which will be discussed in the succeeding chapter.

The Accounting Challenge in Perspective

The real challenge to accountants posed by the concept of
social responsibility is change. Accounting does not exist in a
vacuum; it is an integral part of a rapidly changing society and all
its socio-economic activities. Consequently, stagnance is a luxury
for the profession. As Roy and MacNeill put it: "he /the accountant/F
must be prepared to grow with changing conditions and ideas." 25  But

24Hubbard, op. cit., p. 11.

25Robert H. Roy and James A. MacNeill, "Horizons for a Pro­
ession: The Common Body of Knowledge for CPAs," The Journal of
Accountancy. Vol. CXXII (September, 1966), p. 44.
until today, accountants are still debating such concepts as truth, objectivity, conservatism, verifiability and other concepts identified with quantitative data, while the real problems that should be faced have already gone far beyond these concepts being debated upon.

Robert Trueblood laments the tendency of the accounting profession to push its traditional affinity toward absolutism to excess. He added that "although the goals of accounting are highly relevant in our time, traditional accounting has declined in relevance to contemporary needs."

The feeling is pervasive not only in the accounting profession but also in other disciplines which are knowledgeable of the utility of accounting in broad perspective. The internationally known economist, Adolf J. H. Enthoven, who have worked with the problems of developing economies concurs with Trueblood:

Moving accountancy out of its present narrow dogmatic sphere of operation toward a more effective socio-economic development function will be a slow and perhaps a rather tedious task; but if this objective is not pursued, other disciplines may start filling the eco-accountancy needs and the accountancy may become too important to be left to accountants.

Just as corporations are having problems in dealing with their widening social role under the corporate social responsibility concept, the accountants are divided as to how their active social role shall be carried out. Bowen's study indicates that stalwarts


in the profession like Maurice Moonitz, A. C. Littleton, and William Paton favor the involvement of accountants in social concerns as individuals rather than the accounting profession itself. MacNeill indicated that the study group that participated in the seminar "Public Accounting - 1980" sponsored by the California Certified Public Accountants for Education and Research in 1971, believes that social consciousness should be practiced by individual CPAs. Professor Moonitz sums up his feelings in his letter to Bowen:

> To sum up, I strongly believe that we should become involved as citizens interested in improving our society. I also believe that the professions, as presently constituted, are poor vehicles for social action, and are limited in what they can do; therefore, in what they should try to do. If we need new organs of social action, and I feel we do, then let us forge them, and not try to make do with groups whose "mission," if you will, is different.

The individual basis approach suggested above may not be the logical way of getting involved not only because of the narrow limits of individual action but also because of the complexity of the problem. The professional organizations, like the American Institute of Certified Public Accountants, the National Association of Accountants or the American Accounting Association, have the resources in terms of expertise and finances. A coordinated and unified approach to involvement would be more efficient and effective.

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28 Bowen, op. cit., pp. 53-57.


30 Ibid., p. 56.
Summary

The social contribution of the accounting profession has always been performed indirectly, that is, society is benefited because whenever the accountant helps a client survive competition in the marketplace, induce investment by adding credibility to the financial statements, render management advice which result, in greater profits, etc., the accountant is doing a great service to society. Recently, with the advent of the corporate social responsibility concept, this passive role has been transformed into a direct or active involvement in social issues such as aid to small business, recruiting and training of minorities, education of minorities, developing measurements for social programs, etc.

But the profession's direct involvement in social issues is not at all a unison thought and feeling of all the accountants. Some like Professor W. Paton thinks that public or social service is nonsense, for the accountant's function is to provide the best possible service to his specific clients. The majority however, sustains the so-called social responsibility of the accountants.

A definition of the accountant's social responsibility has been offered. On a conceptual or philosophical basis, the concept is defined as encompassing those actions and actuations of the profession which are directly or indirectly intended to perpetuate itself. Perpetuation of the profession requires the satisfaction of dual motives; economic and social. The former is satisfied by serving its clients according to the best ideals and standards of the profession. The social motive is accomplished...
by accepting a behavior which is consistent with the current needs of society.

The philosophical aspect of the definition is that it requires that the accountant's primary loyalty and responsibility is towards his profession. By so doing, the economic and social motives of the profession are satisfied, thus its perpetuation is accomplished.

On the other hand, Linowes provides an operational definition of the profession's social responsibility. These three levels are summarized in (1) service to clients, (2) expanding its function and (3) responsibility of an educated group to its nation and society.

To reinforce the case for a direct involvement in social concerns a social profile of the accounting profession and the accountant has been portrayed. Stressed in the profession's social profile is the fact that as a social institution, the accounting profession is a part of a social process, and therefore, it is a creature of society. It thrives because it satisfies the needs of society. Any default in this respect would diminish the profession's importance, and by the same social process that created it, the profession would be replaced by a new institution which is more responsive to the needs of society.

Emphasized in the social profile of the professional accountant is the call for greater assertion of its importance in promoting business justice, and consequently, social and economic justice. As a member of society, the accountant has an interest in
the well-being of the community and the country as a whole.

The interpretation of the social responsibility of the accountants has to be broadened. As a start, a basic conception or a social postulate has to be formulated to serve as the basis for determining the future role of the profession. Consequently, such postulates shall be the foundation of a socially-oriented accounting philosophy.

Concluding Note to Part I; A Note to Part II

The interaction amongst the society, the corporation and the accounting profession as depicted in Figure I has been discussed in Part I. This interaction creates a changing and a dynamic environment for accounting.

To be responsive to this environment, the accounting profession has to formulate an accounting philosophy which is consistent with the modes, customs, values, attitudes, etc., of society, and upon which an accounting objective can be developed. Such an accounting objective shall, in turn, be the basis for the establishment of sound accounting principles and the related standards and procedures.

Part II will discuss (1) the framework for formulating a socially-oriented accounting philosophy referred to above and (2) a methodology for identifying and reporting the cost of socially-relevant programs of a business enterprise via the traditional financial statement models of the accountant.
PART II

THE ACCOUNTING ASPECTS OF CORPORATE
SOCIAL RESPONSIBILITY

The changing and dynamic environment of accounting discussed in Part I has a far-reaching implication for the accounting profession. While the importance of the profession has reached new levels and horizons, traditional accounting has declined in relevance. The reason is that the accounting profession chose to retain the dogmatic significance of traditional concepts which makes it unresponsive to its dynamic environment.

Of concern to this study is the implication of this changing environment to both the practical and the theoretical structure of the accounting discipline. While the literature is replete with scholarly expositions on the dynamic nature of the accounting profession, the record shows that these expositions are but exhortation to adapt to change. Adaptation, however, appears to be a slow and a painful process for the profession. A keen observer would not miss the fact that the information provided by the accountants based on traditional concepts are extremely inadequate to satisfy the informational needs of the perceived users of accounting data. Therefore, there is a need to reexamine the direction of the accounting profession on both the theoretical
and the applied plane. In this critical reevaluation, accounting theorists have to explore the causes and the circumstances as to why the accounting profession is slow in recognizing and in implementing the effects of its changing environment. Likewise, new direction has to be searched so that the time frame between recognition and adaptation to changes in the accounting environment could be reduced. This aspect of the problem will be explored in Chapter IV.

On the practical aspects of this analysis, accounting thinkers have to find a methodology so that these changes could be reflected in the information provided to the users of accounting reports with a shorter time lag. This will be attempted in Chapter V.
In Part I, the pervasive social order which resulted from the dynamic interaction among the society segments has been discussed. Underscored in the discussion is the fact that the activities of social institutions are under scrutiny, and society demands from these institutions involvement in promoting and in achieving social goals.

The accounting profession, being a social institution, did not escape from this scrutiny. Society is no longer content with the traditional indirect role or contribution of the profession; a more direct or overt role is demanded from the accountants today to help promote such social goals. But the record of the accounting profession is not encouraging. Its main function of providing a communication medium between the corporation and its constituents is jeopardized by the fact that the information content of the accountant's reporting model is inadequate to cope with the requirements of its users. Evidence to support this assertion is not hard to find. In recent years, research groups have sprouted in different parts of the business community selling, in many respects, identical data which could readily be provided by the accounting profession as a result of its traditional function.
Of interest to this portion of the inquiry is the intriguing causes and circumstances which hinder the accounting profession from recognizing and responding to the new demands thrust upon it by the corporate constituencies. The discussion will begin by analyzing the direction upon which the theoretical foundations of accounting have been formulated, and consequently, offer certain explanations as to the main deviation between actual and intended results. This analysis will focus on the works of the American Accounting Association, the American Institute of Certified Public Accountants and other important writings on the subject. To remedy any deficiency(s), this inquiry will offer a framework upon which a contemporary accounting theory may be formulated. Additionally, a methodology for achieving this objective will be offered.

I. THE FOUNDATION OF ACCOUNTING: A PERSPECTIVE

A brief review of the works of well-known accounting thinkers will provide an understanding of the foundation upon which accounting has been built. This understanding is vital in the rethinking process of the profession in defining the contemporary perspective of accounting in its present environment, and in its present place of accounting in the society at large. The succeeding paragraphs will accomplish this objective.

The Social Role of the Accounting Profession

The recognition of the societal significance of the
accounting profession is not novel. As early as 1939, the Accounting Research Bulletin No. 1 of the American Institute of Certified Public Accountants has this to say:

The Committee regards corporation accounting as one phase of the working of the corporate organization of business, which in turn it views as a machinery created by the people in the belief that, broadly speaking, it will serve a useful social purpose. The test of the corporate system and of the special phase of it represented by corporate accounting lies in the results which are produced. These results must be judged from the standpoint of society as a whole -- not from that of any one group of interested parties. (Emphasis added).

In 1940, Professors Paton and Littleton expressed the feelings of, perhaps, most of the members of the American Accounting Association. They contend:

In a changing economy, accounting has been undergoing a change. From a convenient mechanical device, privately applied to the measurement of the status and results of a business enterprise, it has grown into an important medium for the public expression of the important facts about our vast and complex commercial and industrial society. Where the accountant once was concerned merely with assisting the owners of a business to evaluate its operations

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1 The literature on this subject is plentiful. As indicated earlier, the analysis will focus on the activities of the American Accounting Association, American Institute of Certified Public Accountants (hereinafter referred to as AICPA), and other significant accounting authors. It should be noted that a detailed discussion of this matter has been made in Chapter III of this study.

In money terms, he now must recognize a broad social responsibility. \(^3\) (Emphasis added).

In later years, noted individual writers expressed a similar view. In 1948, Paul Grady asserts:

Pride in our profession, if directed into proper channels, ... must cause upon us the full responsibility for meeting the challenges to accounting to expand his usefulness to society in our own generation .... Faithful service to society, of course, embraces the continuous improvements of the various purposes and functions of accounting ... \(^4\)

Subsequent works of the American Institute of Certified Public Accountants in the early sixties articulate similar views concerning the social role of the accounting profession. Two of these works are notable: (1) Accounting Research Study No. 1 \(^5\) and Accounting Research Study No. 3. \(^6\) In October, 1970, the Principles Board of the Institute issued APB Statement No. 4.

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\(^3\)W. A. Paton and A. C. Littleton, An Introduction to Corporate Accounting Standards (Chicago: American Accounting Association, 1940), p.v. Of course, Professor Paton seems to entertain an opposite view in later years. (See W. A. Paton, "Earmarks of a Profession ..." op. cit.).


Part of the exposition in this statement is a reiteration of the social relevance of accounting. It says:

The users of financial accounting information and economic activity in society and in individual business enterprises are aspects of the environment important to an analysis of the problems of financial accounting.\(^7\)

The works of the American Accounting Association since 1966 after its release of *A Statement of Basic Accounting Theory*\(^8\) reaffirms the earlier statements in this regard. Committees have been formed by the organization to research on various aspects of financial accounting and reporting. The reports of these committees are published annually as a supplement to *The Accounting Review*.

The above citations provide us sufficient evidence that the social role of the accounting profession has always been in the minds of our accounting thinkers, whether as individuals or as groups. However, this evidence did not help us explain the inadequacy of our traditional service. Perhaps, a look at the formulation of the objectives of accounting will perhaps give us an insight into the problem.


The Objectives of Accounting

Until today, the most elusive aspect of accounting is the definition of its basic objectives. Earlier attempts to define such objectives did not help much to clarify the situation. However, writers appear to be in agreement that the objective of financial accounting is "to provide economic information about an entity to permit users to make informed decisions leading to an effective allocation of scarce resources and the accomplishment of the organization's goals." 9

The Principles Board of the American Institute of Certified Public Accountants agrees with the above definition, but made a qualification saying that:

The objectives of financial accounting and financial statements are at least partially achieved at present, although improvement is probably possible in connection with each of them. Constraints on full achievement of the objectives arise from (1) conflicts of objectives, (2) environmental influences and (3) lack of complete understanding of the objectives. 10

The Committee to Prepare a Statement of Basic Accounting Theory of the American Accounting Association has expanded this definition and made specific mention of the purposes upon which accounting information has to be used. These purposes are:

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10 AICPA, Accounting Principles Board, APB Statement No. 4, op. cit., par. 24, p. 9064.
1. Making decisions concerning the use of limited resources, including the identification of crucial decision areas, and determination of objectives and goals.

2. Effectively directing and controlling an organization's human and material resources.

3. Maintaining and reporting on the custodianship of resources.

4. Facilitating social functions.  

Apparently, this expanded objective did not impress certain sectors of the profession. In 1971, the American Institute of Certified Public Accountants commissioned a Study Group headed by Robert Trueblood to define the objectives of financial statements. Except for certain added objectives, the most significant of which for the purpose of this study is "to report on those activities of the enterprise affecting society," the Study Group came out reiterating the objectives of accounting suggested in earlier writings. The Study Group, however, recognizes the tentativeness of these objectives. It urges the profession to continue the development of these objectives for they "are not and should not be static."  

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11 American Accounting Association, The Committee to Prepare a Statement of Basic Accounting Theory, op. cit., p. 4.


13 Ibid., p. 66.

14 Ibid., p. 5.
The Social Role, the Objectives, and the Status of Financial Reports

The basic criticism against the accounting profession is that the traditional information it provides has declined in relevance, and to some extent obsolete. Elliott warned us about the obsolescence of accounting as a result of recent technological strides:

Technology has rendered accounting obsolete. Recognition and acceptance of this fact are necessary if accountants are to make meaningful change, rather than fritter away their limited resources trying to repair the creaking, sagging, old machine.\(^{15}\)

Professor Norton Bedford, in his lectures at the University of Edinburgh, underscores the need to expand our current accounting information system to include data on resource waste and pollution:

One of the obvious situations is the failure of the financial transaction concept to disclose the "social costs" of economic activity. The entire concept of an accounting transaction is now bound to the notion of a "private cost." The result is that the many social costs in the form of polluted air, water, and soil, and a host of ecological damages are not recognized by the accounting process. To the extent that social costs did not diverge significantly from private costs, the classical economic assumption, restricting the accounting recognition point to transactions, was not of great concern. But as social costs and private costs diverge, and the extent of environmental damage done by man, indicates that the divergence is of some magnitude, the transaction concept becomes inadequate.\(^{16}\)


\(^{16}\)Bedford, op. cit., pp. 24-25.
A Wall Street financial writer, Frederick Andrews, after examining the inadequacy of information available concerning corporate social performance laments:

... the accounting profession, which sets the rules by which companies report their financial results, has so far taken no steps to require socially related data in routine corporate reports.17

To obtain an understanding about these criticisms, it is important that they be analyzed in terms of the perceived social role of the accounting profession as well as in terms of the specific objectives explicitly defined to be achieved.

First, the social role of the accounting profession as expounded by various writers and the major accounting organizations was broad in scope, however, the specific objectives were not broad enough to accomplish the social goal set by the profession. In formulating the foregoing objectives, it appears that the accounting profession has unconsciously concentrated its efforts to satisfy the known and active users of accounting data. These concentrated efforts make an assumption that the accounting profession knows exactly the users of its financial reports, and to a greater extent, has satisfied the needs of such users. But the fact is that, much has to be known about the users of accounting data. At present, the literature is abundant with writings proposing that the accountant's report has to be directed to a specific user. Latest of these works is a doctoral dissertation at Louisiana State University proposing that accounting

reports shall be directed to financial analysts.\textsuperscript{18}

In exchange for the modest success in its efforts described above, the accounting profession experienced two important shortcomings which are becoming a major setback in the profession's quest for service. These are: (a) its concentration on satisfying known specific users resulted in neglecting the data needs of others. An example is the general public and the various supervisory bodies whose demand for information regarding the contribution of business to the promotion of social goals have not been satisfied; and (b) the interface between the profession and its environment (which is basically society), has been diminished and limited to the intended specific users. As a result, the accounting profession failed to anticipate and to comprehend the significance of the rapid social changes as they relate to its social function and to the accounting data needed by the society at large.

Second, the social role established by the accounting profession for itself has not been taken as a primary objective; the sub-objective known by every accountant as "satisfying the needs of the users of financial data," has been unconsciously moved into a primary objective. This ties in neatly into the traditional indirect and passive concept of the profession's role or service, which states

\textsuperscript{18}Keith G. Stanga, "An Empirical Study of the Extent of Disclosure in the Published Annual Reports of Large Industrial Corporations" (unpublished doctoral dissertation, Louisiana State University, August, 1974.)
that if the accountant helps a business survive the vigorous competition in the marketplace, he is performing his social obligation to society. Obviously, this is a case of optimization of a sub-objective, and a sub-optimization of a primary objective. More importantly, the accounting framework (defined in this study as encompassing all the sequences and activities leading to the formulation of an accounting objective, principles and procedures or rules), if viewed from a systems standpoint is a half-open or half-closed system\(^{19}\) whose basic source of inputs are the specific known and active information users mentioned above. In other words, the feedback loop which maintains the correspondence between the output and the input source is not linked to the main objective (social role), but only to the specific sub-objective (to satisfy user's needs).

Third, the half-open accounting system explains the inability of the profession to recognize the shift in corporate objective from profit maximization to the maximization of other goals. The effect, according to Bedford and Dopuch, is that there seems to be an "implicit assumption underlying accounting procedures that there is a single overall goal of managerial activities, profit maximization."\(^{20}\) Ladd elaborates this point:

\[^{19}\text{As contrasted with an open or closed system discussed by Thomas Prince. The former is capable of accepting inputs from both within the system (or model) and from the environment. See Thomas Prince, Information Systems for Management Planning and Control (Homewood, Illinois: Richard D. Irwin, Inc., 1970), Chapters 8 to 13.}\]

It seems clear, for example, that satisfaction of the stockholder interest in corporations is no longer the sole or even the primary responsibility of corporation managers; yet to a considerable extent accounting concepts and procedures are firmly based on the premise of the paramountcy of the ownership interest. It is perhaps not so clear, but it surely can be argued, that corporations have turned toward maintenance of competitive position, growth, and "good citizenship" and away from maximum profit as their major objective; yet accounting is tightly tied to the assumption that maximum profit, achieved in an essentially short-run, is of the primary objective of the corporation.21 (Emphasis added).

Fourth, the Committee to Prepare a Statement of Basic Accounting Theory of the American Accounting Association attempted to broaden the objective of accounting mentioned earlier.22 However, the Committee was preoccupied with its quantifiability and verifiability standards which forces it to nullify the expanded objectives in order to avoid contradiction and inconsistency. Very recently, the Committee on Environmental Effects of Organizational Behavior of the American Accounting Association, released a comprehensive analysis of the array of implications of reporting for social costs. But its conclusion is that "at the present time public accountants should not attempt to measure and report the total social costs of damage to the


22American Accounting Association, Committee to Prepare a Statement of Basic Accounting Theory, loc. cit.
environment arising as a result of organization behavior.\textsuperscript{23}

Taking these recommendations of both Committees as concluding notes to this section, it is beyond doubt that the accounting profession will be providing accounting data of lesser value and relevance in the future years to come. Elliott has a harsher observation concerning these recommendations and attitude of the profession:

Accountants as a class like ... prefer quantifiable data. This is true because accounting has traditionally dealt with quantifiable financial data .... These persons are apt to look with horror and revulsion at ambiguous and unquantifiable data. They thus tend to see the measurement of social data as not only difficult (or even impossible) but also distasteful and crude.\textsuperscript{24}

Contradiction Between Intended and Actually Pursued Goal

The preceding discussion strongly suggests that there exists a contradiction or inconsistency between the intended goal set by the accounting profession and the goal actually pursued by the accountants. The first inconsistency exists between the social role established by the profession and the specific objectives necessary to accomplish such a social role. This implies that the social role of the accounting profession constitutes its primary objective while the specific objectives encompass the profession's secondary objectives.


\textsuperscript{24}Elliott, \textit{op. cit.}, p. 73.
However, the final result of the whole process is the sub-optimization of the primary objective and the optimization of the secondary objectives. Evidence of this situation is the inability of the profession to provide the information needs of the society at large.

The second inconsistency or contradiction exists between the specific objectives intended to be accomplished and the objectives actually pursued. Thus, the specific objectives established was to provide information to financial statement users. However, these objectives were not realized because the accounting profession is unwilling to relax its quantifiability and verifiability standards. Therefore, the information needs of certain users of financial data concerning the promotion of social goals by business were not satisfied.

These discrepancies or contradictions are known as teleological inconsistencies, that is, a contradiction between the goal actually pursued and the goal intended to be pursued. In such a case, the original primary objective is correct, while the practice has to be revised. But before any revision on the practice shall be made, the accounting profession has to redefine what constitutes its primary and secondary goals. While it has been consistently implied in this study that the primary goal of the profession (and any

profession or institution, for that matter), is service to the total society, it is reiterated in this discussion that the promotion of social goals shall be the global or the primary objective of the accounting profession. Therefore, the traditional objective of the accountants -- to provide data for decision making -- shall constitute its secondary and specific objective necessary to accomplish the global or primary objective. Consequently, principles, practices, procedures and rules shall be formulated to accomplish the secondary objective. In addition, constant correspondence between the primary and secondary objectives, and between the latter and the actual application of the principles, practices, procedures and rules shall be made to ascertain that the actual goals being pursued are consistent with the goals intended to be attained. Evidently, from a systems standpoint the whole accounting framework is transformed into an open system capable of reacting to changes in the environment and to accept new inputs as a consequence of the changed environment. To attain this flexible accounting structure, a new approach to the development of accounting theory has to be employed. A framework for this approach shall be identified in the following sections of this chapter.

II. A STRUCTURE FOR A CONTEMPORARY ACCOUNTING THEORY

The flexibility of a discipline to adapt to changes in its environment depends upon the framework upon which its objectives and basic assumptions are derived, and the related theories and statements deductively formulated from these objectives and basic assumptions. As previously discussed, the accounting discipline does not enjoy
such flexibility because of the teleological inconsistencies and contradictions that exist in virtually every level of the accounting framework. The task of this section, therefore, is to attempt to re-define the existing accounting framework to minimize or eliminate these contradictions so that it could serve as the foundation of a contemporary accounting theory which is responsive to the dynamic demands of its environment.\textsuperscript{26}

Socially-Oriented Accounting Philosophy

To maintain the flexibility of the accounting profession, it is important that the accountants should reorient its efforts to serving the total society. This means that service to society, directly or indirectly, shall be the primary concern of the accounting profession, and it shall become the basic philosophy\textsuperscript{27} upon which specific accounting objectives, standards, practices, and procedures and rules shall be formulated. The need for this orientation is

\textsuperscript{26}For the purpose of this section, the following terms (some of them has been used loosely in the preceding discussions) have to be defined rigorously, to mean:

Theory - a cohesive set of hypothetical, conceptual, and pragmatic principles forming a general frame of reference for a field of study. (See The Committee to Prepare A Statement of Basic Accounting Theory, op. cit., p. 1.)


\textsuperscript{27}The term philosophy as used in this context means "a system of principles for guidance in practical affairs." (The Random House Dictionary ..., Ibid., p. 997.)
essential if the accounting profession is to eliminate the inconsis-

tency between the far-reaching effect of its influence and the narrow

sphere of influence it has presently recognized. Konrad Engelmann

elaborates this point by saying that the far-reaching influence of the

profession "clearly evidences the need for establishing fundamental

concepts and principles based on an ideology which should be in har-

mony with the theoretical, ethical, legal and practical requirements

of our times."

Obviously, the narrow sphere of influence and service assumed

by the accounting profession today poses certain risk of obsolescence

for the accountants. Paul Grady put this clearly:

The real risk is whether new challenges will be recognized

and successfully met in a timely and adequate manner. Recogni-

tion of the challenges to accounting must be based

upon an analysis of the major challenges to our country, and on a broa-

der scale to our civilization, to ascertain

wherein accounting can make constructive contributions.

That the accounting profession has failed to recognize and

met the challenge on a timely and adequate manner is beyond question.

Ladd contends that "contemporary accounting provides the form but not

the substance" of the information needed by decision makers today.

This appears to be particularly true in the emerging diversification

of goals (multi-goals), in practically all large corporations. Bedford


28Konrad Engelmann, "In Search for Accounting Philosophy," The


29Grady, loc. cit.

30Ladd, op. cit., p. 33.
and Dopuch urge the profession to consider means of broadening its scope to report on the effectiveness with which non-income oriented goals are attained. Ross advanced the emergence of a new class of shareholders in addition to the direct suppliers of corporate capital. He describes them as follows:

The consumer and the public constitute perhaps a new class of shareholders who do not own the physical and financial assets of the company but have a stake in the social or non-proprietary resources like air and water which are often used as raw materials.

To sum up, the orientation of the profession's service to the total society and making such a social role or service the basic philosophy of accounting would provide a constant correspondence between the service required by society and the service offered by the profession. This also provides a sort of an intelligence network and an early warning system for accounting to recognize and anticipate social trends where the potentials for constructive service is possible.

**Broad Structure of Accounting Theory - The Bedford and Dopuch Model**

In the era of multi-goals for the large corporation, Bedford and Dopuch suggested a framework for the development of a broad structure of accounting theory which could provide "a basis for the accounting study of the trend toward multiple goals in the large

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31 Bedford and Dopuch, op. cit., p. 64.

32 Ross, op. cit., p. 48.
The Bedford and Dopuch model "begins with the premise that the need for accounting is predicated upon a condition of scarcity of the means available to remove the 'lacking' or 'wanting' developed from the basic needs and the secondary goals of individuals." In this respect, they suggested that "scarcity" may be defined in an economic, sociological, psychological or philosophical sense.

Consequently, the pattern of behavior which evolves from the premise is essentially along the lines of the following frame of reference:

-- goals are adapted to remove or relieve the needs which exist;

-- means necessary to accomplish the defined goals are selected;

-- the nature and extent of the results which can be expected are set forth; and

-- the states of progress made toward goal accomplishment are evaluated.

Obviously, the model is a product of an inductive process which seems to be a common characteristic of a problem-oriented approach to formulating a solution or explanation to a particular problem or phenomenon. The basic objection to this approach is its firefighting characteristics, the end result of which is its failure to anticipate possible problems. Unfortunately, the problems of the accounting profession in recent years have been partly the result of this approach.

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33 Ibid. 34 Ibid. 35 Ibid.
A Deductive Process Approach

This study adopts the deductive process for the development of a broad structure of accounting theory. The process begins from the profession's socially-oriented accounting philosophy of service to total society to define the specific objectives necessary for its accomplishments. This approach necessitates the formulation of social postulates upon which the "lacking" or "wanting" may be identified. Likewise, the philosophical aspect of the profession's social role may be postulated and made subordinate to the social postulates. Evidently, the ramification of this approach is a complete interface between the accounting profession and the society at large.

Social postulates - According to Professor Hubbard, "social concepts of acceptable behavior or postulates are the basic underlying rules governing social action, and are used by society to measure acceptable performance."

In formulating these social postulates, it will be helpful for the accounting profession to identify the various participants of the corporate enterprise, and to broaden the point of view upon which the accountants satisfy the information needs of these participants. This requires that the corporation as viewed under the entity theory shall be replaced by a broader concept known as the enterprise theory.

Under the entity theory, the corporation is viewed as an

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36 Hubbard, op. cit., p. 11.

37 For a discussion of the other theories or "point of view," see Louis Goldberg, An Inquiry Into the Nature of Accounting, American Accounting Association Monograph No. 7 (Menasha, Wisconsin: George Banta Company, Inc., 1965), Chapter 9, pp. 107-167.
"institution in its own right." Obviously, this concept of the corporation is broader than the legal definition of the corporation given by Chief Justice Marshall of the United States Supreme Court as "an artificial being, invisible, intangible, and existing only in contemplation of the law." Soujanen argues that the implication of the entity concept resulting from the institutionalized nature of the large corporation requires a critical analysis as it affects accounting theory. He argues that the entity concept is legalistic and "isolates the firm as a self-contained abstraction existing apart from the rest of the community."  

In an earlier study, the entity concept was evaluated based on three criteria: (1) suitability of accounting to the social and economic setting of the time and place; (2) adaptability of accounting to the types of institutions employed by the society as well as the identification and portrayal of the relationships existing within the system; and (3) capability of accounting to provide information about the business units needed for rational decisions. The study concluded that the entity concept did not meet all these criteria, and therefore, was not suited to economic conditions existing in the United States. Goldberg in discussing the opinions about the concept in terms of


changes in the set up of a business unit made this observations:

... can it truthfully be said that the viewpoint should have changed in the case of companies immediately after the incorporation of joint-stock companies was legally recognized? And does a shift in viewpoint occur when a partnership is converted into a company? To answer these questions affirmatively is to base the accounting viewpoint upon legal sanction. If, on the other hand, the answer is negative, we are still left with the task of clarifying the viewpoint for accounting purposes in non-legalistic terms.41

The enterprise theory, on the other hand, is socially-oriented, and is responsive to the current thinking and demands of society. It is broader in scope because "it endeavors to discover the role of the firm in society."42 and is based on the idea that the enterprise is an organized association of "any group of persons pursuing a common purpose or system or aggregation of purposes by a course of co-operative action extending beyond a single act, and, for this purpose, agreeing together upon certain methods or procedure,"43 the industrial enterprise is considered a tool of society, and a participant, directly or indirectly, in the activities of the various enterprise constituents having diverse interests and objectives. Charged with the task of mediating the conflicts arising from these diverse interests are the managers who make decisions for the enterprise. They become custodian of the enterprise objectives of survival and growth. These objectives are paramount, and in the decision-

41Goldberg, op. cit., p. 119.
42Soujanen, op. cit., p. 393.
making process, the managers' responsibility is to the survival and to the preservation of the enterprise. Therefore, the rights and interests of the owners are subsidiary to the interest of the enterprise. Philosophically, however, if by virtue of the managers' decisions the enterprise is preserved, the interests of the enterprise participants are also served.

Knauth made one of the clearest portrayal of the enterprise as follows:

Subject to all pressures, management has come less and less to consider itself responsible to the owners and more and more to accept responsibility for the corporation as a whole. It does not oppose the demands of the other parties in the interest of the owner, but on the contrary, attempts to satisfy them all -- dividends for stockholders, high wages and good conditions for employees, friendly relations with government, an approving public, customers who will return for future purchases. In a sense, such a point of view might be interpreted as enlightened stockholder interest, but typically it goes beyond that in the interest of permanence.\(^4\)

Figure 4 shows the relative position of each participant in the enterprise. All of them are joined together to convey that they have a common desire; the satisfaction of their respective goals.

In summary, the entity theory is limited in scope to be the basis for satisfying the needs of the total society. Therefore, it has to be replaced by a socially-oriented concept -- the enterprise theory -- which is broad enough to be the basis for a socially-oriented accounting philosophy.

Figure 4

The Enterprise Theory
Social role postulates of the profession - In postulating the social role of the profession, it may be useful to consider the various areas of accounting as a total service offering to society. These areas consist of the financial, managerial, tax, and the various non-profit activities included under social accounting.

The latter is so relatively new to accountants that certain doubts still exist whether or not it is a proper area of accounting. Goldberg explains the beginnings of social accounting in this manner:

The term "social accounting" has been appropriated in recent years by economists -- with little reference to and less protest from accountants -- to a field which would be more properly described as "national income estimating." Although the expression seems to have taken root, it is certainly not "accounting" as accountants generally understand the word, and it certainly covers only a small portion of the connotations of the words "social" and "society."^{45}

In recent years, the term "socio-economic accounting" emerged. Mobley defined socio-economic accounting as "the ordering, measuring, and analysis of the social and economic consequences of governmental and entrepreneurial behavior."^{46} This area of accounting unques-

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^{45} Goldberg, *op. cit.*, A footnote to p. 7.

tionably expands the traditional areas of accounting to include social consequences and economic effects. This includes governmental accounting, accounting for non-profit organizations, as well as the reporting requirements of socially-relevant programs, particularly the costs of controlling the degradation of the environment. In his attempt to delineate the boundaries of social and financial accounting from a reporting standpoint, Elliott states that the latter reports the use of financial resources to the suppliers of those -- owners and creditors. In social accounting, he contends, the corporation reports on its "use of human and natural resources, who are -- in the broadest sense -- the general public."  

The most important aspect of social accounting which make it different from the other areas of accounting is that it deals with non-financial measures which are beyond the scope of the present generally accepted accounting principles, standards, and practices. This explains the slow pace of its development and acceptance among accountants. Undoubtedly, the integration of this new area into the accounting discipline will enhance not only the image, scope, and the relevance and usefulness of accounting reports but also increase the awareness of accountants of this challenging area. In addition, research in the enormous measurement problems of social accounting will be increased.

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The concept of integration of social accounting into the accounting discipline is shown in Figure 5. The three areas -- financial, managerial, and social -- are linked together to indicate the close relationships among them. Tax accounting is superimposed on the three areas indicating its usefulness and influence over the other areas. Around them is a larger circle representing the limits of the accounting discipline. Unfilled space representing the horizons or areas for expansion is shown around these accounting areas.

With the integration of social accounting into the accounting discipline, perhaps, a new definition of accounting has to be formulated. However, the 1969-70 Socioeconomic Accounting Committee of the American Accounting Association suggests that no new definition is needed because "all accounting is for socioeconomic purposes." This study agrees substantially with the opinion of the Committee, but it feels that the term "social" shall be integrated into the definition. Therefore, if the definition of accounting suggested by the Committee to Prepare a Statement of Basic Accounting Theory is adopted, such definition will read as follows:

... the process of identifying, measuring, and communicating economic and social information to permit informed judgements and decisions by users of the information ....

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Figure 5

A Contemporary Accounting Discipline
To sum up, the integration of social accounting into the accounting discipline will help the profession in postulating its social role as well as present a "full-line" of service offering to the public. Additionally, the development of this new area of accounting will be enhanced by awareness and continued research by the accounting profession.

The Environment of Accounting

The literature is abundant with expositions on the environment upon which the role of accounting is being carried out. Moonitz limits his accounting environment to the economic activity of an "orderly society."50 This includes the economic activities of non-profit organizations, including governmental units, insofar as the "management of economic resources and their conversion into goals and services."51 He continues:

Elements in the environment include natural resources as well as the brain and muscle of human beings, and also imply their combination in all conceivable stages. Furthermore, the goods and services produced are, for the most part, distributed through exchange of some sort, and not consumed by the producers themselves.52

Pattillo provides an essentially similar environment of accounting but he specifically mentions the social and political functions of governmental agencies as providing protection and security

50 Moonitz, The Basic Postulates of Accounting, op. cit., p. 9.
52 Ibid., p. 8.
and promoting the general welfare. Also, specifically mentioned is the existence of an entity to provide the environment.53

The environment of accounting mentioned in APB Statement No. 4 is essentially the same as Pattillo's; however, the needs and expectations of users of financial statements as "part of the environment that determines the type of information required of financial accounting" has been added to the accounting environment.54

In specifying an orderly society as a part of the accounting environment, Moonitz mentioned flux, change, and disorder as always unsettling for accounting which may require either slow or rapid adaptation depending upon the magnitude of these state of affairs. Definitely, Moonitz thinks that accounting languishes in an unstable environment.55

This study believes that society, with its modes, customs, attitudes, and the like, provides the fundamental environment of accounting. Society encompasses all its segments, whether social or political groups, or whether they are individuals, associations, institutions (including the business enterprise), governmental bodies, and others. Therefore, the activities of the society segments which provide the subject matter of accounting shall not be limited to eco-


54AICPA, APB Statement No. 4, op. cit., par. 18, p. 9063.

55Moonitz, The Basic Postulates of Accounting, loc. cit.
conomic activities. They shall include social activities. Likewise, change is pervasive in our society today, and therefore, it is part of the accounting environment. Stability (or instability) is not a critical factor in the environment as Moonitz proposes, for as long as the need for the service of accounting exists, the profession has no choice but to provide such service. Invariably, this is consistent with the profession's philosophy of service to society.

The Objectives of Accounting

In dealing with one another, every segment of society needs either social or economic data. Therefore, it should be the objective of accounting to serve such needs, and accounting principles, standards, practices, and procedures and rules should be related to the need to produce such data which would enable them to deal with each other with the same opportunities, and at the same vantage points.

As discussed earlier, this should be part of the specific objectives of accounting which are necessary to accomplish its global or primary objective as embodied in its philosophy of service to the total society. The various specific objectives of accounting suggested in the literature has been codified by the Study Group on the Objectives of Financial Statements of the AICPA. The study suggests that this codification of financial statement objectives is sufficient as a starting point. It is suggested, however, that because of the rapid changes and the dynamic aspects of society today, such objectives shall be the subject of a continuous review at specified time intervals. The Study Group specifies this point in its transmittal letter to the
Institute president:

... Most importantly, significant efforts should be made to continue progress on the development of objectives from this point on. The objectives of financial statements are not and should not be static, just as the business and financial environment in our country is not static.56

The Accounting Postulates

Accounting postulates play a significant role in the formulation of a contemporary accounting theory. This is particularly true in a deductive system of reasoning. The most significant dictionary definition of postulate in accounting are: (1) "a proposition advanced with the claim that it be taken for granted or as axiomatic," and (2) "an underlying hypothesis or assumption."58 Hendriksen describes the application of these meanings of postulate as follows:

The first of the definitions refers to statements which are assumed to be generally accepted but the validity of which is necessary for the acceptance of other postulates or general principles, standards, or procedures. Even though such a postulate is generally accepted, however, it may be falsified upon further investigation or found to be irrelevant to further development of accounting thought. The second definition of a "postulate" refers to a hypothesis that is as yet unproven and may, in fact, not require proof if it leads to relevant ideas and a logical development of thought and useful conclusions.59

The use of the term in accounting literature denotes either

56AICPA, Accounting Objectives Study Group, loc. cit.

57See the following section on the proposed methodology of this proposed contemporary accounting theory construction.


of these two definitions. That a postulate is a proposition advanced without support or taken for granted has been advanced by Professor Frank Imke in his proposed structure for accounting theory. He indicated that his postulate "is a proposition taken for granted." On the other hand, the Committee on Terminology of the Committee on Accounting Procedures of the AICPA used postulate in the terms of an unproven proposition. It says:

Initially, accounting postulates are derived from experience and reason; after postulates so derived have proved useful, they become accepted as principles of accounting.61

For the purpose of this study, the latter connotation of a postulate shall be used, although, it is admitted that certain postulates that could be constructed based on the accounting structure proposed in this research may fall, as a matter of convenience or otherwise, under the first meaning or usage of the term.62 This summation of postulate by Henriksen is of particular application to this study:

... postulates are basic assumptions or fundamental propositions concerning the economic, political, and sociological environment in which accounting must operate. The basic


61 AICPA, Committees on Accounting Procedures and Accounting Terminology, op. cit., See "Review and Resume" section, p. 11.

criteria are that (1) they must be relevant to the development of accounting logic; that is, they must serve as a foundation for the logical derivation of further propositions; and (2) they must be accepted as valid by the participants in the discussion as either being true or providing a useful starting point as an assumption in the development of accounting logic.63

The Accounting Principles

The accounting terminology committee accepted the dictionary definition of principle as "a general law or rule adopted or professed as a guide to action; a settled ground or basis of conduct or practice ...."64 However, the Committee was quick in giving a warning that:

Care should be taken to make it clear that, as applied to accounting practice, the word "principle" does not connote a rule from which there can be no deviation. An accounting principle is not a principle in the sense that it admits of no conflict with other principles. In many cases, the question is which of several partially relevant principles has determining applicability.65

In other words, while a principle is a guide to action, and the means to obtaining the objective, it is not immutable law. Professor Imke, however, suggests that principles are unlikely to change.66 Sprouse and Moonitz elaborated on this point:

In a dynamic world, detailed rules need to be altered as

63Hendriksen, op. cit., pp. 96-97.
64AICPA, Committee on Accounting Procedures and Accounting Terminology, loc. cit.
65Ibid.
66Imke, loc. cit.
conditions or modes of thought change. But changes in the detailed rules do not necessarily affect the broad principles and basic postulates, all of which are comprehended in the term generally accepted accounting principles.67

While adopting the definition of principle stated above, this study do not agree entirely with the static nature of principles and postulates suggested by Professors Imke, Sprouse and Moonitz. In a dynamic and changing times, the values, modes customs, etc., of society change. As expounded previously, the responsiveness of the accounting profession (and any institution for that matter), to the needs of society it serves, depends upon its ability to recognize and to adapt to these changes. Adapting to the needs of society requires a reexamination of, and ultimately, a change in the objectives of the profession, and since the principles are guide to action and a means of attaining the objective, it follows that such principles (and perhaps, including the related practices, procedures and rules), must also be changed. As already discussed, failure to do so may result in teleological contradictions between the objectives intended to accomplished and the goals being pursued. APR No. 4 agrees with this contention. It says:

Present generally accepted accounting principles are the result of an evolutionary process that can be expected to continue. Principles changes in response to changes in economic and social conditions, to new knowledge and technology, and to demands by users for more serviceable financial information .... Nevertheless, because the

principles are conventional and have been developed in relation to a specific environment and with assumptions about needed financial information, they are all subject to review, evaluation, and possible change.68

In applying the framework of the contemporary accounting theory proposed in this study, it is suggested that the accounting postulates and principles have to be examined critically to assess the impact of the shifting goals of the corporate enterprise from the single-minded profit motive to the emerging multi-goals of the corporation advanced by such writers as Prince,69 Bedford and Dopuch,70 and Ladd.71 More importantly, the time has come to revive the discussion regarding the three principles -- justice, truth, and fairness -- proposed by DR Scott72 in the early forties with reference to the broadened social role of the profession. Pattillo has provided persuasive arguments to support these principles which need further study.73

68AICPA, APB Statement No. 4, par. .32, p. 9065.


70Bedford and Dopuch, op. cit.

71Ladd, op. cit.


73Pattillo, op. cit. For a thorough evaluation of the writings on the literature concerning the rationale and the basis for these principles, see J. Louderback, III, "Ethical Considerations in Accounting Theory Formulations" (unpublished Ph. D. dissertation, University of Florida, 1970).
The Accounting Standards

The Committee to Prepare a Statement of Basic Accounting Theory of the American Accounting Association listed two purposes being served by standards:

... First, they constitute a basis or point of departure for appraising the validity or adequacy of any accounting method in view of the information that it produces; Second, they provide a mechanism for determining the degree of compliance required for information related to a particular use.74

Evidently, the formulation of these standards is crucial in establishing a framework for accounting theory. The reason is that an unnecessarily strict standard reduces the flexibility of the accounting profession in reacting to changes in its environment. Likewise, a lax standard may affect the usefulness of the accounting data. Unfortunately, the accounting profession is confronted with serious problems resulting from the unnecessarily rigid standards formulated by the American Accounting Association. These standards are relevance, verifiability, freedom from bias, and quantifiability.75

In this era of expanding accountability for the corporate enterprise, these standards suffer from obsolescence. As the development and importance of social accounting increases, the standards of verifiability and quantifiability will no longer be useful. Therefore, research in this area necessitates immediate attention. Several concepts are proposed in the literature as possible standards which

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75Ibid., p. 7.
deserve mention in this section.

The common proposal for an accounting standard is identified with the pragmatic approach which adheres to the usefulness of accounting data. Undoubtedly, usefulness as a standard is inadequate; accounting data may be useful but not relevant or vice-versa. The sociological concepts of justice, truth and fairness proposed by DR Scott have some merit for renewed examination because of the social orientation of accounting and the current demands for non-financial reports. Pattillo proposed fairness as his sole standard. However, justice, truth, and fairness have been heavily criticized by accounting thinkers, including Arnett and Moonitz for lack of operational content. In addition, fairness alone as standard proposed by Pattillo suffers from the test of usefulness, that is, an information may be "fair" but perhaps, may not be useful.


77DR Scott, loc. cit.

78Pattillo, op. cit., p. 6.


80Moonitz, The Basic Postulates of Accounting, op. cit., pp. 3-5.
Sorter and Johnson proposed a rather novel way of reporting accounting data. Known as the "events theory," it seeks to report accounting data with lesser aggregation so that such data could be used by a wide variety of decision models. Faced with serious criticisms regarding the relevance of data, Sorter argues that the "events" theory seeks to report the event which is relevant by acquiring knowledge of the users' needs.

Fremgen's proposal for the formulation of accounting principles appears to be more relevant in the formulation of standards. His proposal seems to combine the usefulness concept, "events" theory and fairness. He objects to the definition of the financial statement users because of the danger of biasing the contents of the report and neglecting other potential users. Current reporting practice was criticized by Raby because he felt that reporting and interpreting an accounting phenomena are being done simultaneously in our accounting reports. He suggested that the reporting aspect of accounting shall be separated from the interpretation. Under his

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84 Fremgen, op. cit., pp. 458-459.

85 Ibid.

proposal, special reports (interpretation) may be prepared for a
specific group needing the data. 87 Although Raby did not touch on
accounting standards, his idea is interesting because it could
influence the formulation of accounting standards.

Putting these proposals together, it is possible that a
meaningful basis for a flexible accounting standard could be identi-
fi ed. Starting with Raby's argument, he maintains that there is no
real owner of the entity but the entity itself which maintains good
relationship with the various participants. 88 This argument estab-
lishes, as it was established in Chapter II that the entity is real;
therefore, in reporting the activities of the entity, the report
shall not be intended to fit any particular decision model. The report
shall be constructed from the entity's point of view, that is, to
report what actually transpired in the entity during a specified time
period. Interestingly, this is similar to the "events" theory
advanced by Sorter and Johnson. Moreover, since the report covers
what actually transpired in the entity, and from the entity's point
of view, no financial data user is favored, and therefore, each user
can find his relative interest in the entity. Conceivably, this
situation fits into the fairness standard proposed by Pattillo.

Raby wants the reporting and interpreting of what transpired
in the entity to be segregated. Reporting of what transpired may
convince accounting scholars that very rigid accounting standards
similar to those suggested by the American Accounting Association may

87 Ibid., p. 455. 88 Ibid., p. 454.
no longer be useful. As a result the development of social accounting may be speeded up, and the accounting profession would be able to report all the activities of the entity, including social programs, that affects the welfare of the total society. This type of reporting model is consistent with the objectives of the sociological approach of theory construction. Similarly, the ethical concepts of truth justice, and fairness will also be satisfied because accounting reports the truth of what transpired in the entity. In addition, the report is made from the point of view of the entity which would remove the possibility of favoring anybody. This satisfies the truth, justice and fairness concepts of the ethical approach.

Also, Fremgen's proposal which encompasses usefulness, the "events" theory, and fairness will be satisfied. Finally, the standard of relevance will also be adopted for pragmatic reasons.

In summary, if accounting reports what transpired in the entity, the controversy as to the most preferable accounting standard will be settled to the satisfaction of all the protagonists.

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89 The basic criticism against the concepts of truth, fairness, and justice is addressed to their subjectiveness. It appears that critics of these concepts define them in terms of an outsider's (external to the firm), perception. In other words, the critics' concept of truth is what people think it is true, rather than truth itself. This writer thinks that this view beclouds the potential value of these concepts. Truth shall be defined in terms of what happened not what people think happened. Therefore, the concept of truth is served by reporting what transpired in the entity. Obviously, this meaning of truth is consistent with the "events" theory and Raby's "reporting what transpired in the entity." On basis, justice and fairness would be subservient to truth, because what is true is fair and just."
The Accounting Practices, Procedures and Rules

Accounting practices encompass all actions which involve the application of accounting knowledge in specific situations. While these are actions which give effect to the generally accepted accounting principles, they should not violate the accounting standards. Obviously, the accountant is free to use or experiment any practice he chooses as long as it is consistent with the constraints imposed by accounting standards. This explains the existence of many accounting practices, as well as alternative accounting practices.

Accounting procedures and rules are the specific actions underlying accounting practices. These specific actions are so plentiful that codification is virtually impossible. Professor Imke classified these procedure and rules into instructions and activities. Instructions, according to Professor Imke are "statements concerning what is to be done and how and why an accounting activity is to be performed. On the other hand, activities are actions necessary to carry out the instructions. Classified as instructions are rules and directives, while procedures and methods are combined under directives."

Proposed Contemporary Accounting Theory
Structure: A Recapitulation

A step by step description of the proposed contemporary
accounting theory structure is presented below:

**The accounting environment** - The accounting profession is a social institution; its fundamental responsibility is to serve the needs of society. Therefore, its realm of activity and influence is determined by:

1. Society itself, and all the institutions, social, economic, or political, and individual groups within it, characterized by pervasive norms, values, conduct, attitudes, etc.

2. Interactions and activities of society segments, including the modern corporation, which provides the data as the subject matter of accounting.

3. Change which serves as a catalyst for a dynamic society.

Social postulates have to be formulated to assure a logical foundation of the entire theory structure. An example of this social postulate may be worded as follows:

There is an emerging shift in corporate behavior from the maximum profit criterion to the promotion of multi-goals as well as the goals of the individuals and society.

**The accounting philosophy** - The accounting profession must formulate a fundamental statement of its social role. This statement must be broad enough so that the service offered by the profession is oriented towards the total society. Of significance to this statement is the total service offering of the profession (to some extent, this serves as a constraint), represented by its tax, managerial, financial and social accounting services. This fundamental statement was discussed earlier as a socially-oriented
accounting philosophy. Consequently, postulates shall be derived from this service philosophy or fundamental statement. This postulate may be worded as follows:

Accounting exists to serve society by providing economic and social data in accordance with the needs of decision-makers to promote the effective and efficient allocation of scarce resources.

The accounting objectives - These are the specific objectives of accounting to implement the broad social service philosophy of the corporation. A recent example of such specific objectives is the Study Group’s report on the objectives of financial statements.

The accounting postulates - These postulates are derived from the specific objectives mentioned above. These are basic assumptions upon which principles rest. As conceived in this study, these postulates may not be different from the postulates mentioned in the literature. No attempt, however, has been made to prove this assertion. Of course, added postulates have to be formulated to cover the responsibility of accounting in dealing with non-financial (social) activities of the firm.

The testing process - These postulates have to be tested or verified to ascertain their usefulness or applicability. Thereafter, the postulates that withstand the test and found useful shall form part of the accounting principles.

The accounting principles - These principles may be generally accepted or just accepted by the profession under certain specified circumstances. Moreover, they are guides to accounting action.
The accounting standards - These are concepts against which accounting actions must be judged. They serve as a point of departure or as a mechanism for judging compliance with the desired quality or specification of the outcome (accounting information) produced.

The accounting practices, procedures and rules - Accounting practices involve the application of accounting to specific situations. These are actions that are necessary to give effect to accounting principles. Accounting procedures and rules are the specific actions underlying accounting practices. These accounting practices, procedures and rules must produce results which meet the test of accounting standards.

A graphical presentation of this contemporary accounting theory structure is presented in Figure 6. Certain ideas in presenting this structure has been adopted from the works of Professor Imke.

The Accounting Methodology

The approach to the formulation of the proposed structure for a contemporary accounting theory is a cross-section of six research methodologies. First, the theory structure is conceived

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92 Imke, op. cit.

Figure 6

A Structure for a Contemporary Accounting Theory
as a system of interrelated parts, therefore, the basic approach is a systems approach. Second, the integration of social accounting in the accounting discipline adds another area of inquiry for the profession. The information provided by this relatively new area articulates the effects of business operation to the total society. To this extent, the sociological approach is an appropriate methodology for this inquiry.

Third, the output (accounting information) of the system (structure) should not be biased towards the needs of a particular group of users. The enterprise theory suggested in this study requires that the information output of the accounting system shall be truthful, just, and fair to all the participants in the enterprise. Consequently, the ethical approach has to be employed.

Fourth, the formulation of the concepts, statements, assumptions, postulates, etc., follows from the general to the specific; that is, accounting identifies its role from the total society, followed by specific formulations to give such role a reality. This approach is the deductive method. Fifth, the testing process of the formulation may require retracing from the bottom to the top. Therefore, the inductive method will serve this purpose.\footnote{\textit{A. C. Littleton stated that it is possible to trace the actions upwards through the various stages of the structure; or downwards from the top objective to the lower level. See A. C. Littleton, \textit{Structure of Accounting Theory}, American Accounting Association, Monograph No. 5 (Menasha, Wisconsin: George Banta Company, Inc., 1951), pp. 124-127.}}
Finally, the ultimate test of the formulation is its application to the real world. The test is, for the most part, realized if the output of the accounting system would be useful to the total society. Thus, the pragmatic approach is an appropriate methodology for this study.

Summary

This chapter has explored the implication of the changing environment to both the practical and theoretical framework of the accounting discipline.

The first part of this chapter attempts to explain the causes and circumstances which prevented the accounting profession from recognizing and responding to the new responsibilities thrust upon it by the participants of the corporate enterprise. The analysis focuses on the works of the American Accounting Association, the American Institute of Certified Public Accountants and other significant writings on the subject.

It was ascertained that the broader societal significance of the accounting profession has been expressly recognized and embodied in Accounting Research Bulletin No. 1 issued in 1939 by the American Institute of Certified Public Accountants. Subsequent works expressed similar awareness for such social responsibility.

For years, there was no definite definition of the objectives of accounting. However, various writers seem to agree that the objective of financial accounting is to provide economic information about an entity to permit users to make informed decisions. Later, the
Committee to Prepare A Statement of Basic Accounting Theory of the American Accounting Association expanded the definition to include (1) the control of human and material resources and (2) to facilitate social functions. However, in 1971, the American Institute of Certified Public Accountants commissioned a Study Group headed by Robert Trueblood to define the objectives of financial statements. The Study Group's report was issued in 1973.

The analysis suggests that the consensus of progressive accounting thinkers is that while accounting has experienced new levels of significance, the traditional information provided by its declined in relevance. The following reasons are deduced from the analysis:

(1) there seems to be an existing inconsistency between the specific objectives and the social role of the profession.

(2) the primary objective of the profession (social role) was made subservient to the sub-objective of providing users with financial data.

(3) due to the reasons cited in (1) and (2) above, the accounting profession fails to recognize and comprehend the shift from maximized profit motive of the corporation to the advancement of multi-goals.

(4) the profession's strict adherence to objective and verifiable data explains its inability to recognize the growing inadequacy of the traditional transaction-based accounting system to changing demands of the accounting environment.

Altogether, these problems strongly suggests that there is a teleological contradiction between the intended goals to be pursued and the actual goals being pursued by the profession.
The second part of this chapter proposes a framework for establishing a contemporary accounting theory. The basic argument advanced in this section is that the ability of a discipline to adapt to its changing environment depends upon the framework upon which its objectives and basic assumptions are derived. As pointed out previously, the profession suffers from a teleological contradiction between the objectives intended to be attained and the objectives or goals actually pursued.

As far as it could be ascertained the literature is sparse with regard to proposals for a structure for a contemporary accounting theory which is responsive to the changing needs of society. The most significant of these proposals is that of Bedford and Dopuch. However, this model was dismissed by this study because of its limited and "firefighting" characteristics.

The proposed framework starts by recognizing that the accounting profession is a social institution, and therefore, its fundamental role is to serve society. The study suggests that social postulates be formulated to gain a thorough understanding of the workings of society. In this regard, the study suggests that the entity concept be replaced by a broader concept known as the enterprise theory.

The basic social role of the profession shall be transformed into a fundamental statement, as broad as possible, to serve as the global service philosophy of the profession. For a meaningful understanding of this service philosophy, it is suggested that postulates shall be formulated. In addition, the study suggests the integration
of social accounting into the accounting discipline.

From this broad service philosophy, secondary objectives needed to attain the primary objective shall be identified. The report of the AICPA's Study Group on the objective of financial statement provides a codification of the various objectives mentioned in the literature.

Postulates shall be drawn from these secondary objectives, and passed through a testing process for verification as to their validity and applicability. If these postulates pass through this test, they become either accepted or generally accepted accounting principles.

To maintain a sort of quality control over the application of accounting practices, procedures and rules, accounting standards have to be formulated. The various proposals regarding these standards have been discussed in this study.

Finally, a methodology which is considered to be useful in proving the coherence, logic, and ultimately, the validity of this accounting theory structure has been identified as a cross-section (eclectic) of six research methodologies: (1) systems approach, (2) sociological, (3) ethical, (4) deductive method, (5) inductive method, and (6) pragmatic.

The next chapter will attempt to identify a methodology for recording and reporting on socially-relevant programs of a business enterprise.
CHAPTER V

ACCOUNTING AND REPORTING FOR SOCIAL PROGRAMS

The preceding chapter has attempted to construct a framework for a contemporary accounting theory. Underscored in the discussion is the proposition that service to the total society shall be the overriding philosophy and the global or primary objective of accounting, and shall be the basis for the formulation of specific objectives, postulates, principles, practices, and procedures and rules of the profession. This structure makes accounting, from a systems standpoint, an open system with adequate capability and flexibility in recognizing and accepting inputs from the environment.

This chapter will deal with the accounting and reporting problems of an area of social accounting -- corporate social programs. The chapter is divided into two sections: first, a discussion of certain problems which have to be clarified or answered in relation to the subject, including a discussion of the proposed methodology for costing social programs, and second, an exposition of the proposed accounting and reporting procedures for social programs in the traditional reporting model of the accountant.

I. PRELIMINARY CONSIDERATIONS

Before the fundamental accounting and reporting problems of corporate social programs or activities could be dealt with adequately,
there are certain questions or points that have to be answered or clarified. This portion of the chapter is devoted to these considerations.

The Need to Account and Report the Cost of Social Programs

In the previous discussions, the need to account and report the social activities of the corporate enterprise has been expounded repeatedly and in general terms. To reinforce such an exposition, more specific reasons, framed from an accounting point of view, shall be offered to place the urgency of the matter in its rightful perspective. First, expenditures for social programs are significant, and estimates of expenditures for environmental control alone "range up to 4% of sales, and up to 10% of capital investments for some individual polluters."¹ In 1972, The Conference Board Record, a non-profit business research organization, reported that in its survey of 789 plants concerning their water pollution abatement activities for a five-year period, 1965-1969, 500 of the respondents indicated a composite percentage rise of 239 percent to a level of $112.6 million in 1969. In addition, it reported that in 1969, 463 plants indicated an expenditure of $65.4 million for operating these pollution abate-

In the area of corporate philanthropy, Standard Oil Company (Indiana), through its foundation created for the purpose, spent $3.5 million in 1972 to support educational, scientific, religious, etc. organizations. These expenditures offer evidence as to the validity of the assertion of Parker and Reimer that "pollution event is relevant to decisions made by investors of business enterprise."^2

Second, the Securities and Exchange Commission has expressed determination to expand its disclosure requirements on financial statement as they relate to the environmental policies set forth in the National Environmental Policy Act. The former Commissioner, William Casey, put this concern as follows:

The Commissioner is to interpret and administer its statutory authority to the fullest extent possible in accordance with the environmental policies set forth in the Act.^

Casey laments that the Securities and Exchange Commission, the account-

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ants, and the financial analysts are slow in dealing with the necessary disclosures of this problem. He says:

The accountants were slow in tightening their rules, the SEC was slow in not requiring the disclosures to correct misleading impressions and the securities analysts were slow in not putting the information which was available in proper perspective . . . . 6

In other words, it is inevitable that the profession will be confronted with the problem of accounting and reporting for these corporations. For instance, in 1971, the SEC issued a guideline requiring corporations registered under the Securities Act and the Securities Exchange Act for disclosure of material matters relating to the environment and civil rights which may affect the capital needs and earnings of the company. 7

Third, the comparability of financial statements is sacrificed. Beams and Fertig elaborate this point:

The problem of comparability in financial reporting practices has received considerable attention from the accounting profession over the years . . . . Now the problem of comparability arises again in connection with social costs and environmental pollution. Some companies within an industry are controlling pollution by making current outlays while others are seemingly ignoring the pollution problem. The operations of some industries are more destructive to the environment than the operations of others . . . . The

6 Ibid., p. 28.

probable result of these differences is that, other things being equal, the worst polluters will appear to be the most successful and they will likely receive additional resources from the investing public.

Fourth, the corporate financial reports are still the most logical source of information for these socially-relevant activities of the business enterprise. Kastenholz agrees with this point:

Clearly, the financial reports of a corporation are the best medium with which to communicate these costs and activities to stockholders on a continuing basis. An obvious reason is that the costs of these social programs would be more meaningful if presented and related to the other costs and expenses incurred by the company.

Fifth, investors, especially the institutional investors, are beginning to include in their investment criteria the social performance of portfolio companies. In early 1972, the Ford Foundation conducted a study regarding the practice of stockholder responsibility. The survey included 200 institutions -- religious organizations, universities, foundations, insurance companies, banks and mutual funds -- 60 percent of which responded to the study. These respondents indicated that, among other things, they have recently reviewed or are currently reviewing the social aspects of their

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investment policy and that they include social considerations in the selection and retention of investment.\textsuperscript{10} Also, the Committee on Business Standards of the Investment Company Institute recommended that "corporate social responsibility issues should, in the interest of the investment company and its stockholders, be considered as investment issues."\textsuperscript{11} The specific issues recommended to be considered are (1) litigation relating to compliance with Federal and State social, environmental, economic, product safety and advertising standards; and (2) corporate expenditures (including research and development) to insure compliance with such Federal and State standards.\textsuperscript{12} In addition, the Committee listed the following investment companies whose portfolios are selected on the basis of the social responsibility and the profitability of the companies held: Dreyfus Third Century Fund, Provident Fund for Income, and Social Dimensions Fund.\textsuperscript{13} The corporate information committee of the Financial Analysts Federation proposes that "costs, particularly for preventing or


\textsuperscript{11}Investment Company Institute, Committee on Business Standards, "Corporate Responsibility and Mutual Funds," April, 1971.

\textsuperscript{12}\textit{Ibid.}

\textsuperscript{13}Letter from Mr. C. Richard Pogue, Executive Administrator, Investment Company Institute, October 10, 1973.
reducing air and water pollution, should be separated out as a portion of capital expenditures. The overall program should be described as well as the time required to accomplish it.\footnote{14}

Finally, the information function of the accounting profession is diminished due to the inability of the traditional financial statement models of the accountant to disclose these data. This is supported by the appearance of a number of research groups which are peddling social program data to corporate management\footnote{15} which could be provided by the accountant as a by-product of its attest function.

\textbf{Current Reporting Practices for Socially-Relevant Programs}

There appears to be a sustained growth of awareness on the part of corporations to report their socially-relevant programs. This observation is based on certain studies probing into the reporting practices of corporations engaged in various social projects.

In 1971, Norman Pope conducted a study of the reporting practices of corporations within the five industries which were identified as high polluting industries, namely: chemicals, energy,
forest products and packaging, metals and utilities. The study covered 136 annual reports for 1969 and 125 annual reports for 1970. These annual reports were read separately and divided into three sections for analysis, namely; letters to stockholders, body of the annual report, and financial statements. Pope reported that references to pollution abatement increased steadily in the three areas of analysis in these annual reports.  

A close look into this study indicates that while there was an increase in the reference made to pollution cost in the financial statements, the overall progress in reporting is extremely discouraging. In fact, Pope considered this situation as a violation of the "full disclosure doctrine" established by the accounting profession.  

Moreover, in a complementary study by William, Caldwell and Needles on the same sample of annual reports, they indicated that only seven reports (about 5 percent) of the composite sample (136 annual reports in 1969 and 125 for 1970), contained any references to pollution matters in footnotes and/or financial statements. Therefore, practically all disclosures of these matters were made on a narrative basis.

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17 Ibid., p. 84.

A similar survey was made recently by the accounting firm of Arthur Andersen & Co. on the 1972 annual reports of Fortune's 1000 largest industrial companies and the 50 largest commercial banks, life insurance companies, diversified financial companies, retailing companies, transportation companies and utilities. The main purpose of the survey was to ascertain the extent of disclosures made by the respondents on six selected topical areas: human resources, energy and mineral resources, land resources, environmental protection, civic participation and consumer protection. Although the study did not specify the location in the annual reports upon which these topical areas were disclosed or mentioned, it could be inferred that the disclosures were made in narrative form and, most probably, in the letter to stockholders and/or in the body of the annual reports. This assertion is supported by Kastenholz findings in his recent cursory review of annual reports. He found that:

. . . Reporting social issues in annual reports increased eight-fold between 1960 and 1970, and it is continuing to rise. I recently went through the annual reports in our own files and discovered that 75 percent of them treated the exercise of social responsibility in either the narrative section or in the President's letter or both.

To sum up, while disclosures in corporate annual reports regarding socially-relevant projects are increasing, such disclosures are made in narrative form. Moreover, Norman Pope's conclusion that


20 Kastenholz, loc. cit.
this situation is a violation of the profession's "full disclosure
doctrine" mentioned earlier appears to be still tenable.

Social Audits

The progress toward the disclosure of socially-relevant
programs in corporate reports appear to have been affected by the
aroused interest on social audits which occupy a considerable space in
expositions relating to social measurements. The importance of
social audits has been underscored abundantly in the literature,
meetings, conferences, symposiums, etc. Even David Rockefeller pre-
dicted that in the future, social audit information will be required
to supplement financial statements.

Social audit defined - The term has not been widely defined
in the literature. However, there seems to be a wide agreement as to
the scope of the concept, that is, taking a critical look at the
impact of a corporation on society. Bauer and Fenn offer a definition

21 Bernard Butcher, "The Program Management Approach to
of social audit which reflects the widely accepted meaning of
the concept: "a commitment to a systematic assessment of and
reporting on some meaningful definable domain of a company's
activities that have social impact."²²

Embedded in the conduct of a social audit is the deter­
mination of an adequate measurement which would quantify the costs
and the benefits of corporate social activities. Dilley expanded
his definition along this line:

... an investigation of an enterprise's performance
as a member of the community in which it has its
primary impact; such investigation consisting of
the preparation of an inventory of the socially­
relevant activities of the enterprise, a monetary
quantification of the social cost and benefits
resulting from those activities, and compilation
of other quantitative information providing insight
into the social performance of the enterprise.²³

Approaches to social audit - There are a number of approaches
which might be used in conducting a social audit. These methods
or approaches can be grouped into four categories: (1) "negative"
approach, (2) external group priorities method, (3) specific
program criteria approach and (4) cost-benefit quantification method.

The "negative" approach appears to be the simplest of
these approaches, but less meaningful, subjective, and perhaps, hap­
hazard. Bauer and Fenn describe this method as "simply to collect
evidence that a company is doing 'no social harm' or is not currently

²² Bauer and Fenn, "What is a Social Audit," op. cit., p. 38.

²³ Dilley, op. cit., p. 91.
under indictment by a governmental body." This method has not been thoroughly discussed in the literature.

The external group priorities method relies on the subjective opinions and impressions of knowledgeable and concerned people known as reference groups. This approach was expounded by Professor Allan Shocker\(^2\) of the University of Pittsburgh, Graduate School of Business. It retains the customer sovereignty concept in marketing. Simply stated, this approach proposes that corporate social action is a function of what the priorities of the reference groups are. The shortcomings of this approach is how to select a priority which would satisfy the company's "social customers" from among the variety of priorities which the reference groups may conceive, bearing in mind the financial constraints of the company. Apparently, this approach is trying to combine a social program priority-setting method and a social audit.

The specific program criteria approach takes a specified area of activity and subject it to a detailed and critical review.

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\(^2\)Bauer and Fenn, *The Corporate Social Audit*, op. cit., p.16.

An example of this approach is the corporate rating method used by research and special interest groups such as the study prepared by the Council on Economic Priorities on Air and Water Pollution. Also, this approach is used by institutional investors in selecting a "clean portfolio" stock. Another method under this group is the Social Indicator Approach pioneered by HUD, HEW, and the General Accounting Office to quantify the impact of social programs, such as job training, low-cost housing, day care centers, etc.

The fourth group - the cost-benefit quantification method -- attempts to quantify the costs and benefits of corporate social programs. This approach occupies the literature on the subject of social audits. Several methods are proposed under this group:

1. **Inventory approach** - Proposed by Bauer and Fenn, this method proposes the conduct of a social audit as a first step, and for internal decision-making purposes only. The approach takes an inventory of all existing social programs of the company, and subjects them to a critical review and evaluation. Its main thrust is merely to learn about the social programs of the company.

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26 Butcher, op. cit., p. 10. See also the report of Longstreth and Rosenbloom to the Ford Foundation, op. cit.

27 Ibid., p. 9a.

28 Bauer and Fenn, "What is a Social Audit?," op. cit., pp. 43 - 45.
(2) **Program management approach** - Pioneered by Bank of America, this method proceeds by identifying the firm's social activities, quantifying the cost of the program, and ascertaining whether or not the objective has been met. In effect, the company sets a specific objective for each social program and at some future date, justifying the cost in terms of the attainment of the predetermined objectives.

(3) **Cost or outlay approach** - This approach was used by Dilley in his social audit of a Midwest utility company. It starts with the identification of the firm's social programs, and indicates the expenditures for the activity. Included in the final report is a disclosure of quantitative but non-financial information such as minority persons hired during the year, the number of pounds of sulfur emitted into the air, etc. 29

(4) **Constituent impact approach** - This approach was pioneered by Abt Associates 30 which seeks to present in the traditional accounting model, particularly the balance sheet and the income statement,


the social costs and benefits of the company's operation to its
constituents -- employees, customers, suppliers, the immediate
community, and the general public. This approach has been
criticized for its abstract and complicated results which only
a few could understand.

(5) Area of disturbance - operation approach - This
approach was expounded by this writer during the NACBS symposium as
an alternative to Bank of America's program management approach,
to Bauer and Fenn's inventory approach and to Shocker's customer
sovereignty method. It seeks to identify the social programs of
the company, ascertain whether or not the firm is a direct party
to causing the problem (direct disturbance as a single firm, and
direct disturbance on an industrywide basis), identify the cost
involve in pursuing the program, and concentrate corporate efforts
on those problems which the firm is causing. This approach is
complementary to the priority-setting criteria established in
Chapter II, Section II of this study.

Despite these approaches, however, the state of the art
is still at its crudest stage. Part of the problem is that while
an adequate methodology could be devised to account for the cost
of social programs, the determination of the corresponding benefits
poses an extremely difficult problem.

Implication for the accountants - That accountants could
play an important role in conducting social audits is beyond question.

31 Bauer and Fenn, "What is a Social Audit?," op. cit., p. 43.
However, the profession should take this new field as a special activity, the product of which is a special report which is needed to supplement the traditional accounting reports of the accountant. In this frame of reference, the profession shall strive to find a suitable methodology so that the cost of social programs could be reported in the accountant's reporting model. The advantage of this approach is obvious. The cost of social programs (which are of financial significance) would be more meaningful if it is reported along with all the financial matters of the company. Unfortunately, the attention of the profession is directed towards the problems of social audit than to report the cost of social programs in the financial statements.

The Problem of Measurement

The fundamental issue which confronts the conduct of social audit is the measurement problem. As pointed out earlier, an adequate methodology could be devised to measure the cost of corporate resources committed to social activities. However, measuring the benefits derived from these social activities is almost an unsurmountable problem. The reason is that from the standpoint of accounting (and other disciplines for that matter), measurement means absolute dollar terms. This is engrained in every principle, standard, practice, etc. of the accounting profession.

But the reality of the problem is being overlooked. While the sacrifice in pursuing a social program could be expressed in dollar terms, the benefit derived from it does not generally yield to monetary measures. The Accounting Objectives Study Group of the
AICPA put this point succinctly:

The sacrifices incurred to achieve social goals can be separated and described — and so can the benefits, but most likely not in dollars. These sacrifices might include the amounts donated to a hospital or spent in hiring and training handicapped people. The results can be reported in terms of additional hospital bed capacity or the number of handicapped employed. To go further in reporting the relationship between private and social sacrifices and benefits is difficult, because the sacrifice is largely monetary and the related benefit is mainly nonmonetary.32

In taking a general view of the measurement problem of these social activities in so far as it relates to accounting, the immediate exhortative suggestion of a contemporary accountant is to relax our existing measurement techniques. But, perhaps, this relaxation of our measurement methods is not critical from a financial accounting standpoint. Three main interrelated considerations may clarify this point.

First, the thrust of the profession's efforts to solve the social measurement problem is addressed to the problems of social audit. This excludes the more basic and fundamental responsibility of accounting to provide useful and relevant information to users of corporate financial reports. In other words, the immediate problem of the profession is how to report the cost of corporate social activities in its traditional financial statement model. However, the question which may not have been asked so far is:

Does the accounting profession have suitable techniques to ascertain the cost of these social activities?

Second, the discussion regarding the measurement of benefits derived from these social activities have not clarified the question "benefit to whom?" If this question is conceived as benefit to the company (that is, direct benefit), the logical conclusion would be that our understanding of a social activity needs a similar clarification. The inevitable explanation is that if a firm helps a minority businessman, for instance, the former spends the money and the latter reaps the benefit. The indirect benefit to the company, if such a benefit exists, may be goodwill and improved image.

Of course, our present generally accepted accounting principles do not sanction the recording of this type of goodwill or image, not because of measurement considerations but because of lack of logical basis. If, however, the benefits derived from a social program is intended for the recipient which may be an individual, a group of persons, or society at large, then the problem of measuring, recording and reporting such benefit may no longer be a problem. Consequently, the monetary value of corporate resources committed to these social activities are treated in the financial reports just like those array of expired costs and expenses for a particular accounting period which could not be reasonably related or traced to a particular benefit (revenue).

Third, the current emphasis on the social audit does not help us identify the particular needs that this sophisticated endeavor is to satisfy. More importantly, in facing the problem,
the accountant's attention has been so completely absorbed and overwhelmed that the significance, information-wise, of corporate social activities has not been scientifically dissected from the vantage points of both internal (management) and external users of the information. Unquestionably, the information needs of these users are not identical. It is speculated in this inquiry that foremost to external users of corporate reports is the direct and overt involvement of the enterprise in social activities. Therefore, the most relevant aspect of a social program for these external users is the resources committed, which could reasonably be translated into absolute dollars. Accepting this premise, then the measurement problem for external reporting is simplified. On the other hand, internal users need more information regarding these social activities for their concern is the effective and efficient utilization and allocation of scarce company resources. But even with these expanded needs, the elaborate product of a social audit with all its various sophisticated measurements may not be needed. The proximity of internal users to the details of corporate affairs and the pragmatic aspect of internal decision-making make the decision models of this group of users open to qualitative input.

To sum up, the measurement problem relative to social activities is addressed to the social audit, the product of which is a special report which may be used as a supplement to the traditional financial reports of the enterprise. But this report does not relieve the accounting profession from reporting the cost
of social activities in its traditional reporting model. To cope with this responsibility, the costs of social activities have to be identified, measured and reported. This inquiry contends that the accounting profession has adequate techniques and capabilities in accordance with generally accepted accounting principles to handle the problem.

A Methodology for Accounting and Reporting the Cost of Social Program

In order that corporate social activities could be communicated to users of corporate reports, this study proposes that both quantitative and qualitative data concerning these social activities be reported in the traditional financial statement models of the accountant. The quantitative aspect of these data shall be measured in terms of the cost of pursuing these social activities. For the purpose of this study, costs shall be defined as:

Input costs which, except for air and water pollution projects, may consist of (1) direct out-of-pocket expenses (in certain instances, incremental costs); (2) time spent by company personnel in pursuing the program; and (3) a certain portion of the department overhead. For pollution activities, these input costs may include: (1) the depreciation of the physical facilities; (2) administrative costs; (3) cost of operating the facilities; and (4) in certain cases, research costs. These costs specifically exclude opportunity costs.

The qualitative aspect of these data shall include non-financial statements and representations of corporate management which could readily be disclosed in the footnotes to the financial statement models. Current accounting practices include the
necessary procedures and rules to reasonably verify these data.

Actually, as will be noted in Chapter V, the application of this input cost methodology encompasses a cross-section of various social audit methodologies discussed earlier, namely; the inventory approach, the cost or outlay approach and the program management approach. The inventory approach is particularly essential for companies which are making an initial review and costing of their social programs.

The 1969-70 Committee on Non-Financial Measures of Effectiveness of the American Accounting Association appears to favor this approach as a method of measuring quantitative effectiveness. The Committee says:

First approximation of quantitative effectiveness measures might be measures of the amounts of the resources being devoted to achieving these goals, the amount of charitable contributions made by the firm and its employees, costs being borne by the company as a result of training and employment of disadvantaged citizens, the use of the firm's physical facilities and of its employees' talents for civic purposes, etc. 33

Similar applications of these methodology has been noted in the literature. In 1972, Dilley made a social audit of a Midwest gas and electric utility company using the cost or outlay approach to measure the resources committed to social activities. He suggested

a format for presenting the results called a "Social Responsibility Annual Report" (SRAR).

Linowes uses a similar methodology in quantifying the costs of "socioeconomic items" for his proposed "Socioeconomic Operating Statement" (SEOS).

It should be noted that the applications mentioned above were intended for a social audit. John Tepper Marlin utilized the same approach but extended his discussion to the reporting problems of social activities, and suggested a procedure for attesting to the resulting data. However, he expressed strong reservation about the use of expenditures as an index of performance because "a statement of expenditures by itself tells us nothing about how much of a job had to be done and how much pollution remained after it was completed." He proposed that the corporation should report the status of its pollution control facilities in relation to the latest control technology (state-of-the-art control equipment standard) and its compliance with acceptable emission standards (acceptable

34 Dilley, op. cit., See also Dilley and Weygandt, op. cit.


Marlin, however, did not specify the specific location of this disclosure in the financial statements. Of course, the methodology proposed in this study will disclose such information as a footnote to the financial statements. Two other applications were intended for internal decision-making which took into account the cost of using corporate funds for the purpose. The Bank of America is the pioneer in this area. In addition to measuring the costs (less any applicable income) of its social programs, it included a certain amount of opportunity cost. Dixon and Thornton used the methodology in ascertaining the overall cost of a waste treatment facility with adequate provision for the cost of capital used in the project.

II. IDENTIFICATION AND CLASSIFICATION OF COSTS OF SOCIAL PROGRAMS

Before a meaningful discussion of the accounting aspects of social programs could be accomplished, there is a necessity for identifying and classifying the cost of these social programs. Using input cost methodology as proposed earlier, this section will attempt

37 Ibid., pp. 42-44.

to identify the corporate resources committed to this activity, and
to attach monetary values to these resources.

In order that the resources committed and the resulting
dollar values could be verified, the discussion will be limited to
pollution control and abatement expenditures as well as certain
social programs which were studied in Chapter V. It is believed,
however, that the resources committed to pollution control and to
the other social activities of the firm would not differ significantly
from industry to industry or from company to company level.

Classification of Costs of Social Programs

For a more meaningful reference to the costs of social
programs, the following classification of these costs are offered.
First, classified as to intent or purpose, the cost of social activi-
ties may be preventive or refurbishing. This type of classi-
fication is generally addressed to pollution control and abate-
ment expenditures. Preventive costs are those intended to prevent
present or future pollution damage to the environment. In this con-
text, it may be difficult to identify that portion of the cost

\[39\] As far as it could be ascertained, the literature does
not provide any information as to the costs incurred in undertaking
various social programs. In fact, the Committee on Environmental
Effects of Organization Behavior recommended that research has to be
undertaken to define what constitutes pollution control and abatement
expenditures. See American Accounting Association, Committee on
Environmental Effects of Organization Behavior, 1973, op. cit.,
p. 116.
which is applicable to the prevention of present or future damage to the environment. The reason is that actions to prevent present pollution and damage may eliminate such a problem in the future. Refurbishing costs are those expenditures intended to correct a past damage to the environment or to restore the area to its original or former state, shape or appearance. Examples of these are the restoration of the land surface as a result of strip mining, oil exploration and drilling, defoliation of the area as a result of a particular activity, etc.

Philosophically, however, this classification may apply to almost all social programs. For instance, social programs addressed to the needs of minorities may yield to such classification: preventive in the sense that the intention of a social program is to bring the minorities into the mainstream of American life; refurbishing to the extent that the intention of the program is to correct past injustices to these minorities.

Second, the costs of social programs may be classified as to the manner by which company resources are committed. Under this classification, these costs may be referred to as direct or indirect commitment of corporate resources. The former refers to direct outlays such as investment in pollution control facilities, corporate philanthropy, administrative costs of undertaking the social program, etc. Indirect costs may include personnel time spent in pursuing the social activity, supplies, opportunity costs, etc.
A third classification may refer to the driving force which induces the firm to undertake certain social programs. Under this category, the costs of undertaking the social activity may be classified as either voluntary or involuntary. The voluntary costs of social programs may encompass all costs of such programs pursued by reason of conscience or self-interest other than by virtue of any governmental rule or standard. Involuntary costs include all expenditures necessary to meet a government standard. This is common in pollution control cases and in the case of safety standards of the company. A question was raised under this classification regarding the expenditures incurred by the company to attain a level of activity over and above the standards set by the governing authority. The answer to this query depends on the extent to which the classification is carried through. It is obvious, however, that the costs incurred in excess of the legal requirements fall under the voluntary classification.

Identification of Corporate Resources Committed

For the purpose of this study, the resources committed to social activities of a company are identified separately for pollution control and abatement activity and for the other social programs of the firm.

With respect to air and water pollution abatement and other environmental damage control, the items listed below represent the significant components of company resources involved or committed to these projects:
(1) capital investment or outlays in pollution or environmental control facilities

(2) human talents and resources committed to the project

(3) operating cost outlays

(4) research costs for improving the technology for pollution abatement and environmental damage control

For other social programs, the following are the significant corporate resources involved:

(1) direct cash outlays incurred either to pursue the program or as a direct contribution in the case of corporate philanthropy

(2) human talents and resources involved or committed

(3) share of company or department overhead

(4) in some instances, outlays for certain equipment or facilities such as training aids, donation of office equipment, etc.

Attaching Monetary Values to Resources Committed

By using input costs as a methodology for measuring or quantifying the cost of social programs, the company resources involved or committed as mentioned above may be translated into dollar terms. For pollution abatement and control of environmental damage, these resources may be translated as follows:

(1) The capital outlays have to be depreciated over the life of the asset based on the company's depreciation polices. If the pollution control equipment is a feature or an integral part of the plant machinery and equipment, the depreciation expense shall be the excess over the normal depreciation charge if the plant
machinery and equipment do not have the pollution control feature. This would perhaps pose some problems, and even result in arbitrary estimates. However, the engineering staff of the company and the manufacturer of the equipment may be of tremendous help in solving the problem.

In the oil industry, this problem appears to have been remedied. The industry has developed guidelines to identify the percentage component of an equipment item which is intended to control air and water pollution and other environmental damage.

(2) The human resources committed to the project may be included under administrative costs, which consist primarily of the salary and benefits of the personnel hired or retained to operate the facilities. If the existing personnel is utilized to oversee the operation of the facilities, the salary expense and benefits to be charged to this activity shall be the amount of time spent multiplied by the average hourly compensation rate (base pay plus benefits) of such personnel. Some companies have a composite labor rate which is used for inter- and intra-departmental or company labor charges.

(3) Operating costs may consist of outlays for:
   (a) repairs and maintenance
   (b) fuel or power costs. If the pollution

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and other environmental control equipments are an integral part of the plant and equipment, fuel or power costs shall be the excess of the normal (average) fuel or power expenses incurred in operating the system without such pollution and other environmental control features. To arrive at this figure, the firm's engineers as well as the manufacturer of the equipment has to be consulted. In the oil industry, fuel or power costs can be ascertained by using the American Petroleum Institute guidelines.41

(c) insurance premium on policy purchased to protect the facilities.

(d) property taxes levied on such facilities.

(e) other operating costs such as supplies, and other costs.

(4) Research and development costs for improving the technology on these matters. This may include environmental impact studies of proposed company operation.

With regard to other social programs, the resources committed may be translated into dollar terms as follows:

(1) Specific direct costs and expenses incurred in the project. For instance, in hiring minorities, the recruiters may make special trips to, say, all black university or may retain an employment agency to search for potential qualified minority employees. The direct cost of this social program is the incremental cost incurred in interviewing at a minority school (excess of this cost over the expenses incurred in interviewing at traditional campuses),

41 Ibid.
as well as the excess charges of an employment agency engaged to aid recruiting minority employees.

(2) The dollar value of human resources or talents utilized in the program may be included in the administrative costs of the project. If the personnel spends all their time working on the program, their salary and benefits shall be included in the cost of the project. However, where the personnel spends only a portion of their time pursuing the program, the cost identified with it shall be determined by multiplying the standard labor rate by the number of hours spent on the program.

(3) Share of department overhead. Generally, this cost is immaterial, unless the whole department has been organized solely to work on the project. An example of this is the environmental, social responsibility, or public affairs office of a corporation.

(4) In instances where the company buys certain equipment for its social projects (like training aids), the cost of such equipment shall be a part of the total cost of the program.

III. ACCOUNTING FOR COSTS OF SOCIAL PROGRAMS

A review of the literature on this subject indicates that, except for an article on accounting for pollution costs, there is no significant discussion of the accounting aspects of these

42 Beams and Fertig, op. cit.
social programs. The very few articles on the subject were specifically addressed to the reporting problems of pollution control activities.

The reason for this situation, as mentioned earlier, is that the whole attention of the accounting profession is directed towards the measurement problem as it relates to social audit. In addition, the 1972 Committee on Environmental Effects of Organization Behavior of the American Accounting Association recommended that at the present time "public accountants should not attempt to measure" and report on pollution matters.

In analyzing the costs of social programs, it appears that the accounting problem involved with these costs is not as complex as it appears at the surface. Their accounting treatment is not different from the accounting for costs and expenses incurred by a company in its regular operations. The American Accounting Association's Committee on Environmental Effects of Organization Behavior indicated that the transactions identified with environmental effects are usually internalized in the accounting system and are

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similar in many ways to typical transactions of an organization. This supports the assertion of Professor Wood that the accounting problem is simple because it involves primarily "the consideration of capitalizing versus expensing outlays, capitalizing of leased facilities, the adequacy of depreciation allowances, etc."

In light of these findings, the purpose of this section is to summarize the accounting treatment of the costs of social programs in accordance with generally accepted accounting principles.

Cost of Pollution Abatement and Control of Environmental Damage

The costs of pollution abatement and control of environmental damage (net of corresponding savings or income such as recoveries of raw materials lost in the process), for a particular period identified earlier as the (1) depreciation of the physical facilities for environmental control, (2) administrative costs for undertaking the project, and (3) operating costs shall be treated as current product costs in accordance with the opinion of the Accounting Principles Board of the AICPA to the effect that "net income should reflect all items of profit and loss recognized during the period . . ." This was also the accounting treatment for pollution costs

46 Wood, op. cit., p. 75.
Research and development costs shall be expensed or deferred depending upon the practice or policy of the company. The accounting method followed, however, has to be disclosed, generally as a footnote to the financial statements, as required by the Accounting Principles Board.

Refurbishing costs or costs to restore past damage shall be accounted for as a correction of prior year's earnings. These costs satisfy the criteria established by the Accounting Principles Board regarding the items that have to be accounted for in this manner. There are, however, certain refurbishing costs which are charged to current operations. In the oil industry, for instance, the cost of restoring the environment after an oil spill is charged to current operations. In this particular case, while the cost of maintaining safeguards against an oil spill is a current production cost, the cost of cleaning the environment, and all subsequent costs to restore the area to its pre-spill condition shall be treated as an extraordinary item in accordance with the Principles Board opinion on this matter.

48 Beams and Fertig, op. cit., p. 40.


50 AICPA, Accounting Principles Board, "Reporting the Results of Operations, op. cit., par. 22, p. 1017. See also Beams and Fertig, loc. cit.

51 Ibid., pars. 19-22.
As indicated earlier, the identification of costs attributable to the prevention of current and/or future pollution or damage to the environment may be an extremely difficult problem. In fact, these costs might not be separable. Beams and Fertig recognize this difficulty, but nevertheless urged that efforts be made to solve the problem. They did not, however, provide a methodology for dealing with the problem.

A careful analysis of these costs reveals that they include the depreciation on the physical facilities used to prevent present and future pollution or damage to the environment, administrative costs, operating and maintenance costs, and perhaps, research costs. Therefore, they are accounted for as production cost for the period.

A company may be faced with the obsolescence of its facilities so that economic considerations may indicate that the replacement of such facilities is the best alternative for the company to take. Therefore, if the company decides to replace these facilities, the write-off of these assets shall be accounted for as an extraordinary item in accordance with the accounting treatment recommended by the AICPA for this particular transaction. If the write-off of the facilities would amount to or result in a discontinuance of the operation of a segment of the company's business,

52 Beams and Fertig, loc. cit.

53 AICPA, Accounting Principles Board, "Reporting the Results of Operations," op. cit., par. .19 -.21, pp. 1109-1110.
the accounting treatment is still similar to the accounting recognition for extraordinary items. However, a specific disclosure procedure is called for as discussed in the reporting section of this chapter.

More often, extractive industries are bound under their lease contracts to correct or restore at some future time, generally, at the expiration of the lease agreement, the damage to the landscape or environment caused by their operations. The restoration (or conservation) program varies from industry to industry or from company to company. In one oil company, the practice is that the conservation program is part of the day to day operation of the production units. Perhaps, the pervasive practice is to undertake the conservation program at the termination of the lease agreement.

The practice of the above oil company makes the accounting problem simple. The cost or expenses incurred in the conservation program is charged to current production cost. On the other hand, if the conservation program is postponed to the termination of the lease contract, generally accepted accounting principles require that the estimated liability for the period be accrued, and the corresponding expense be charged to current operations. While the Accounting Principles Board is not explicit in the accounting treatment for these costs, this study believes that the accounting treatment suggested above is consistent with the spirit of the Board's opinion as follows:
The Board believes that financial statements of lessees should disclose sufficient information regarding non-capitalized lease commitments to enable users of the statements to assess the present and prospective effect of those commitments upon the financial position, results of operations, and changes in financial position of the lessees.\(^5^4\) (Emphasis added)

The proposed accounting treatment is likewise consistent with the intent of the following generally accepted accounting principles:

All known liabilities should be recorded regardless of whether the definite amount is determinable. If the amounts cannot be reasonably approximated, the nature of the items should be disclosed on the face of the summary of liabilities or by footnote.\(^5^5\)

Costs of Other Social Programs

The costs (net of corresponding income, like interest charged for loans to minority businesses), incurred for the other social programs of the company such as helping minority enterprise, purchasing from minority businesses, contributions, and other programs should be charged to expense for the current period. Unrecorded expenses identified with the program should be accrued at the end of the accounting period.

Contingent Liabilities

Contingent liabilities arising from legal action against

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\(^5^4\)Ibid., par. 07, p. 3523.

\(^5^5\)Paul Grady, Inventory of Generally Accepted Accounting Principles for Business Enterprises, ARS No. 7 (New York: American Institute of Certified Public Accountants, 1965), p. 65.
the company as a result of the damage inflicted on the environment shall be disclosed in the financial statements in accordance with generally accepted accounting principles. Likewise, if any action resulted in a judgment against the company, the liability shall be recorded in the accounts of the enterprise.

Where standards have already been set by the government but the company has not made any provision for their compliance, contingent liabilities may also be recognized in anticipation of possible legal action and a judgment against the company.

Similar accounting treatment is recommended when there are no existing standards or regulation but they are about, with certainty, to be promulgated as a result of public concern or outcry. Of course, the basis for this proposal may be questioned as speculative, and therefore, not verifiable. As such, the recognition of any liability is not in accordance with generally accepted accounting principles. However, the record of government intervention to protect the public welfare is not a matter of speculation; it is a reality. This is manifested by the countless hearings and proposed legislation pending both in state and in federal levels. Professor Wood underscores this fact:

The inability to predict government intervention may be a temporary frailty. Government can be expected to continue to play an expanded role in pollution control. Thus, in due time, government intervention may be imminent when pollution occurs.\(^{56}\)

Depending upon the situation and the magnitude of the case,

\(^{56}\)Woods, op. cit., p. 76.
the contingent liability may be recorded in the accounts or disclosed as a footnote to the financial statements. However, the accountant must exercise judgment in this case because such recognition of the contingent liability may be interpreted as an admission of guilt or wrongdoing.

IV. REPORTING FOR COSTS OF SOCIAL PROGRAMS

The preceding section has shown that the input costs of social programs can be accounted for in accordance with generally accepted accounting principles. But the pressing problem that confronts the accounting profession is whether or not these costs have to be reported in the traditional reporting model of the accountant. Obviously, the weight of opinion based on the very few writings on the subject leans heavily towards reporting these matters.

Actually, this question is addressed to the full disclosure doctrine required under the reporting standards promulgated by the AICPA. Therefore, to appreciate the reporting problems for the cost of social programs, this section will start by reviewing the full disclosure requirement for financial reports. The remainder of the section will deal with the manner of reporting and disclosing the social activities of the enterprise.

Full Disclosure Doctrine for Financial Reports
and Corporate Social Activities

The full disclosure doctrine\textsuperscript{58} is an outgrowth of the third standard of reporting promulgated by the Committee on Auditing Procedures of the AICPA as follows:

Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.\textsuperscript{59}

This disclosure requirement has been explained by the Committee in this context:

The fairness of presentation of financial statements in conformity with generally accepted accounting principles comprehends the adequacy of disclosures involving material matters. These matters relate to the form, arrangement, and content of the financial statements with their appended notes; the terminology used; the amount of detail given; the classification of items in the statements; the bases of amounts

\textsuperscript{58}Griffin and Williams prefer "adequate disclosure" from "full" and "fair" disclosure because the term represents "a reasonable and practicable reporting objective." "Full" disclosure may indicate superabundance of accounting information while "fair" disclosure may suggest the application of a "moral judgment in establishing limits of disclosure." Charles H. Griffin and Thomas H. Williams, "Measuring Adequate Disclosure," The Journal of Accountancy, Vol. CIX (April, 1960), p. 44.

\textsuperscript{59}AICPA, Committee on Auditing Procedures, Statement on Auditing Standards, Codification of Auditing Standards and Procedures No. 1 (New York: American Institute of Certified Public Accountants, 1973), par. .01, p. 78.
set forth, for example, with respect to such assets as inventories and plants; liens on assets; dividend arrearages; restrictions on dividends; contingent liabilities; and the existence of affiliated or controlling interests. This enumeration is not intended to be all inclusive but simply indicative of the nature and type of disclosures necessary to make financial statements sufficiently informative.  

Birnberg and Dopuch attempted to elaborate on the conceptual aspect of disclosure "geared to the responsibilities which the accountant will be called upon to fulfill in the future." They said:

...the concept of disclosure assumes that the appropriate framework should follow a classification and measurement scheme based upon the goals adopted by the enterprise, the expectations underlying the acquisition and utilization of a means of accomplishing these goals, and a comparison of results anticipated to the results actually achieved. A failure to supply these data would require interested parties to interpolate the motives and expectations of management to evaluate the results obtained in any period of operation.

In viewing the social activities of the corporation from the standpoint of the full disclosure doctrine, the immediate conclusion that can be drawn from this observation is that the doctrine has been violated. Norman Pope drew such a conclusion on this basis. In discussing the doctrine in relation to the pervasive reporting method for these social programs, he concludes:

60 Ibid., par. 02.


62 Ibid., p. 58.
This principle (full disclosure) provides that care should be exercised to be reasonably certain that the significant financial facts are appropriately disclosed either in the body of the Financial Statements or in the notes and parenthetical statements associated with them. Many companies violated this principle of accounting in their Annual Reports by (1) including pollution cost and contingencies under general headings which tend to conceal any relationship to pollution, or (2) completely ignoring pollution cost and contingencies for financial reporting purposes. (Emphasis added).

Underscored in the above quotation is the word "significant." Therefore, the non-disclosure of a fact, financial or otherwise, about the operation of a company would violate the full disclosure doctrine only if such fact is significant. The word "significant," according to Webster's dictionary, is something "deserving to be considered; important; momentous." Needless to say, the importance of social activities of the enterprise has already been demonstrated up to this point of this study. Therefore, the assertion that the non-disclosure of these activities violates the full disclosure doctrine is well supported.

In talking about pollution costs, Beams and Fertig strengthen this conclusion by invoking the lack of comparability of financial statements without these disclosures. Specifically they propose that:

Accounting can and should provide disclosures on pollution costs so that financial statement users are informed of company efforts at abating pollution.

63 Norman Pope, op. cit., p. 83.

64 Webster's New International Dictionary, op. cit., p. 2335.
and of the possible lack of comparability in financial statements of different firms. 65

**Reporting Pollution Abatement and Control of Environmental Damage** 66

Affected by the reporting methods and techniques suggested in the following paragraphs are the (1) balance sheet; (2) income statement; (3) statement of capital and retained earnings and (4) statement of changes in financial position.

**Balance Sheet** - One of the significant disclosures in the balance sheet regarding pollution abatement and control of environ-

65 Beams and Fertig, op. cit., p. 42.

66 The most comprehensive exposition on the reporting techniques for pollution control costs and expenditures related to the control of environmental damage has been made by the 1972 Committee on the Environmental Effects of Organization Behavior of the American Accounting Association. (See American Accounting Association, Committee . . . , 1973, op. cit.) There is a striking similarity between the reporting methods and techniques conceived in this study and those proposed by the Committee. It should be noted that the report of the Committee was published several months after the research proposal of this study was written, and subsequently submitted to the accounting faculty for comments and approval, and to Arthur Andersen & Co. Foundation for funding. To acknowledge this similarity, proper quotations and footnotes shall be made to these points of agreement. (For purposes of this section, the phrase "the Committee" refers to this particular 1972 Committee of the American Accounting Association).
ment damage refers to the physical facilities acquired for this project. Current practice buries these facilities among the depreciable assets of the enterprise represented in the balance sheet by the general caption — property, plant and equipment.

The major objection to this presentation, aside from the lack of recognition given to these facilities, is that the importance of these equipment items is not articulated, let alone the materiality of the amounts involved. The Committee argues that these facilities have a "unique function," and therefore have to be disclosed separately. Therefore, these pollution abatement and environmental control facilities should be taken out from the property, plant and equipment caption and be presented as "property plant and equipment - pollution abatement and environmental damage control," "pollution control facilities" or other terms of similar import. This presentation satisfies the requirements of the Accounting Principles Board of the AICPA regarding the disclosure of depreciable assets to the effect that the "balances of major classes of depreciable assets, by nature or function, in the balance-sheet date" shall be disclosed in the financial statements or notes thereto.


The Committee raised an excellent point regarding the portion of the cost of the new expansion facility constructed with the most modern technology, including the environmental abatement controls, that should be grouped with the other types of environmental control facilities. Three possible solutions were offered: "(1) the additional cost incurred due to the inclusion of special environmental control components, (2) the entire cost of the project, or (3) none of the costs." The Committee suggested the first solution, but appears to prefer the third choice because of the possibility that the equipment may not be available without the pollution control features.

Apparently, the above question may no longer be critical. Two avenues are open to the company: First, solicit the help of the manufacturer of the equipment as to the details and estimated cost of the pollution control component. Second, the guidelines could be developed by the industry which the company is a part. This is being done by the American Petroleum Institute for the oil industry. For instance, a smokestack that reduces the pollutants emitted into the air is considered as 100 percent pollution control equipment.

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69 American Accounting Association, Committee on Environmental Effects of Organizational Behavior, loc. cit.

70 Ibid.

71 American Petroleum Institute, loc. cit.
Footnote to pollution abatement and environmental damage control facilities - The information content of the above presentation is inadequate to portray the whole picture of the pollution abatement and environmental damage control activities of the company. John Tepper Marlin raises this point in this manner:

... a statement of expenditures by itself tells us nothing about how much of a job had to be done and how much pollution remained after it was completed. 72

This problem could be eliminated by adding a footnote to these environmental facilities. On the minimum, this footnote shall contain the following: 73

(1) The relative contribution of the industry and/or the company to the pollution and other environmental problems. Preferably, the location of the company and its contribution to the environmental problems in the area shall be stated (for instance, the air pollution problem caused by U.S. Steel at Gary, Indiana).

(2) The laws, state and/or federal, applicable to the environmental problems caused by the industry and/or company. State the period of compliance. In most instances, this should be stated in general terms because of the various laws which the company has to comply. For instance, the Clean Air Act of 1970, as amended, requires all states to submit plans of compliance, and to implement them not later than 1977.

72 Marlin, op. cit., p. 42.

73 See also the disclosures proposed by Beams and Fertig, op. cit., p. 42.
(3) Statement as to the program of compliance set by the company, its annual goals, and its annual accomplishments compared with the goals.

(4) An elaboration of the goals in pursuing the program of compliance whether or not it is below, equal to or above the legal requirements or standards set by governmental authority.

(5) Statement as to the future plans of the company.

Also, there is a need to disclose the method of valuation and allocation of the costs of these assets in instances when they are an integral part of technologically advanced factory equipment. This appears to fall under the "customary or routine disclosure" requirement of the Accounting Principles Board and the Committee on Auditing Procedures of the AICPA. For an illustration of this disclosure, see Appendix A.

Liabilities - The liabilities recognized and accounted for earlier arising from lease or other executory contracts and


This disclosure is not concerned with leases per se, but on the non-capitalized lease commitments to restore or prevent any damage to the environment. See AICPA, Accounting Principles Board, loc. cit., par. 07, p. 1523. See also the Accounting Principles Board opinion on par. 10, additional disclosures required for the financial statements of the lessee, "Disclosures of Lease Commitments by Lessees." Ibid., p. 3524.
imposition of governmental regulations and standards recognized as liabilities for the period under generally accepted accounting principles shall be accomplished with a footnote explaining the nature of these liabilities. This could be accomplished, however, by "keying" them to the footnote on the expense side of these liabilities in the income statement, or vice versa (see discussion on the income statement disclosures below).

The judgment of the accountant is needed in dealing with these liabilities because the amounts may not be material in terms of the popular usage of the materiality concept. It is suggested, however, that these liabilities are better judged under the relevance standard than under the concept of materiality.

Footnotes are also suggested to accompany definite commitments or recognized liabilities arising from self-imposed restoration or prevention of past or future environmental damage.

Plans to commit (and subsequently incur a liability) company resources arising from self-imposed environmental damage control activity require a similar footnote. This takes the form of a general footnote to the financial statements, and therefore, should not be included in this portion of the balance sheet. This footnote could be, though not strictly so, a part of the general contingency footnote discussed below.

Contingent liabilities - There are three main possible types of contingency footnote required under this category:

1. A contingency footnote arising from existing legal
action to restore past environmental damage or due to inadequate compliance (or non-compliance) with governmental regulation or standards. Generally, the estimated amount of this litigation shall be stated. If the amount is not reasonably determinable, the disclosure requirement by the Accounting Principles Board is as follows:

If a monetary estimate of the amount involved is not feasible, disclosure should be made in general terms describing the contingency and explaining that no estimated amount is determinable. When amounts are not otherwise determinable, it may be appropriate to indicate the opinion of management or counsel as to the amount which may be involved.76

(2) Those that may arise from a possible action to restore past environmental damage or compliance with a standard or regulation about to be promulgated or passed by a governmental authority as a result of a public outcry or in the course of its duty to protect the public interest. This is particularly true with pollution control standards which the states are required by a federal law to develop and submit in a plan of compliance to the Environmental Protection Agency. These standards must be implemented not later than 1977. At this point, most of the states are still working on their respective plans.

To some extent, the liability in this case appears to be certain, only that the amount is not reasonably determinable. On this basis, the disclosure requirement applicable seems to be the one quoted above.

Professor Wood added a dimension to this problem which makes the accountant's course of action unclear. The hypothesized case is that there are no government controls or standards and the company is not controlling its pollution and has no plans of doing so. Wood suggested three points to be considered to solve the auditor's dilemma: (1) loss of image by the firm as its irresponsibility becomes known, (2) much greater cost in the future if action is delayed and (3) the social costs of continued pollution.

Obviously, whatever conclusion the audit may come up with would be severely questioned. It would not be farfetched to conclude that the company would hesitate to consider the issue for inclusion in its financial statements. A possible course of action which the auditor could take is to warn the company of the possible consequence of the situation either in his transmittal letter or in a separate letter to management.

(3) The most significant of these contingencies is the uncertainty that questions the going concern assumption with respect to a particular enterprise. Consider these quotations by Beams and Fertig, all from December, 1970 issue of The Roanoke Times:

The State Water Control Board of the Commonwealth of Virginia has set July, 1972 as the deadline for American Cyanamid Company's Piney River plant to cease polluting the Piney River. The high cost of the new controls which would be necessary to halt the pollution led to the announced closing of the plant and the possibility of throwing 325 people out of work.

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Wood, loc. cit.
The Saltville, Virginia, sodium ash plant of Olin Mathieson Corporation is scheduled for closing by 1972. The history of this plant dates back to 1893 and the reason for closing is simply that the plant cannot meet the prevailing water quality control standards. About 650 people will be out of jobs if the anticipated shutdown occurs.  

Commenting on the water quality standards approved by the Environmental Protection Agency in October 1973, The Wall Street Journal stated that to meet these standards, the oil industry has to commit $1 billion for the next four years. Unfortunately, the magnitude of this amount, if imposed on a single company, even to General Motors Corporation would result in its certain extinction.

The problem is how to disclose this condition in the financial statements. Unquestionably, the independent auditor has a sufficient ground to disclaim an opinion on the financial statements taken as a whole. As such, the disclosures required for a disclaimer of an opinion apply.  

If the plant (or segment of business) is eventually

78 Beams and Fertig, op. cit., pp. 40-41.


80 See disclaimer of an opinion requirement in AICPA, Committee on Auditing Standards, "The Fourth Standard of Reporting," op. cit., p. 83.
abandoned, the disclosure requirements are discussed under "discon-
tinuance of a segment of a business" below.

Income Statement

Just like the costs and expenses incurred in the company's
regular business operation, the costs and expenses recognized by the
company in its social programs may be classified into manufacturing
and non-manufacturing costs. These costs and expenses are classi-
fied on this basis below:

Manufacturing - costs and expenses incurred as a result of
the company's pollution abatement and environmental damage control
activities:

(1) depreciation
(2) administrative costs
(3) research and development costs
(4) accruals for estimated liabilities arising
    from executory contracts to restore or
    repair damage to the environment at the
    termination of the lease agreement.
    In certain instances, the environmental
    conservation program is part of the
    operating routine of a company, thus,
    these costs and expenses are actual
    outlays or commitments.
(5) accruals or actual outlays or commitments
    arising from self-imposed restoration or
    pollution abatement and environmental
    damage control programs.
(6) other costs and expenses.

Non-manufacturing - These costs and expenses consist of expen-
ditures or outlays for other social programs identified earlier.

These programs may include assistance for minority enterprise, day
care centers, contributions, minority purchasing programs, and other social projects.

Current practice includes these costs in the multitude of costs and expenses recognized by the company during a particular period. Therefore, to articulate the significance of these costs and expenses, the preferred presentation is to set them up as a separate caption in the manufacturing (or cost of sales) and in the non-manufacturing (or operating cost) sections of the income statement. This presentation shall be accompanied by a footnote detailing the social programs being undertaken, the costs incurred for each program on a comparative basis, as well as a statement of the future goals of the company in this respect. Such account titles as "pollution abatement and environmental damage control expenses" (manufacturing) and "cost of social programs" (non-manufacturing) or other captions of similar import may be used.

However, current practice in consolidated financial statements is to aggregate all the costs and expenses for the period under a very limited number of functional classifications such as cost of goods sold and general, administrative and selling expenses. In most income statement presentation, however, interest expense occupies a separate caption in the operating cost section of the statement because the amount appears to be significant. In considering the total cost of the other social programs of the company which has to be included in this section of the income statement, it appears that the magnitude of such total cost is not as significant (or material) compared with, say, interest expense. This
might raise, for one reason or another, some objections in presenting this cost as a separate caption. Likewise, objections may be raised to create another caption in the cost of goods sold section to present that portion of manufacturing costs arising from these social activities.

On this basis, the presentation suggested by the Committee through "schedules, explanatory footnotes or additional details" may be used. On the minimum, this presentation should disclose (See Appendix B):

(1) the method or procedure in computing the amounts.

(2) a listing of each social program and its corresponding costs.

(3) comparison of expenditures this year and last year.

(4) other data which may be included to enhance the information content of the matter.

The depreciation on pollution abatement and environmental damage control facilities may be presented in this section or in the disclosure made for all depreciation expense. The latter is preferred because of the specific disclosure required for this item by the Accounting Principles Board to wit:

Because of the significant effects on financial position and results of operations of the depreciation method or methods used, the following disclosures should be made in the financial statements or in notes thereto:

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(a) Depreciation expense for the period,

(c) Accumulated depreciation, either by major classes of depreciable assets or in total, at the balance-sheet date, and

(d) A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

As mentioned earlier, the accounting policy for research and development costs has to be disclosed as a footnote to the financial statements.

**Extraordinary Items**

Generally, refurbishing costs or costs to restore or repair a past damage to the environment should be accounted for as a prior year's adjustment to net income. An exception to this is an oil spill in the oil industry, the cost of which (less any insurance recoveries) is properly charged to current operation. As suggested earlier, this should be treated as an extraordinary item in accordance with generally accepted accounting principles. A similar presentation is suggested for the abandonment of facilities which do not meet the standards or regulation promulgated affecting the matter.

These costs should be segregated from the results of ordinary operations and shown separately in the income statement, including a

disclosure of their nature and amount. The required disclosure for extraordinary items as suggested by the Accounting Principles Board is as follows:\textsuperscript{83}

\begin{align*}
\text{Income before extraordinary items} & \quad \text{\$xx} \\
\text{Extraordinary items (less applicable income taxes of (\$xx) (Note _ _ _))} & \quad \text{\textbeta}\text{xx} \\
\text{Net income} & \quad \text{\$xx}
\end{align*}

**Discontinuance of a Segment of a Business**

If the segment of a business is discontinued because the standards or regulation promulgated by the government to control pollution and other environmental damage cannot be met without sustained losses to the company, the specific disclosure requirement set by the Accounting Principles Board which is applicable to this situation is as follows:\textsuperscript{84}

\begin{align*}
\text{Income from continuing operations before income taxes} & \quad \text{\$xx} \\
\text{Provision for income taxes} & \quad \text{\textbeta}\text{xx} \\
\text{Income from continuing operations} & \quad \text{\$xx} \\
\text{Discontinued operations (Note _ _ _):} \\
\text{Income (loss) from operations of discontinued Division X (less applicable income taxes of \$xx)} & \quad \text{\$xx}
\end{align*}

\textsuperscript{83}\textit{AICPA, Accounting Principles Board, "Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary Unusual and Frequently Occurring Events and Transactions," op. cit., par. 11, p. 1105.}

\textsuperscript{84}\textit{Ibid., pp. 1103-1104.}
Loss on disposal of Division X, including provision of $xx for operating losses during phase-out period (less applicable income taxes of $xx) xx xx

Net income $xx

Also required is a disclosure as to the nature and amount involved as a result of the discontinuance of the segment's operation.

Statement of Capital and Retained Earnings

Based on the premise that production costs in prior years were understated because the use of "free goods" were not internalized and accounted for as cost during those periods, the subsequent expenditures to repair or restore the damage to the environment as a result of past production activities shall be treated as an adjustment to prior periods' net income in accordance with the criteria established in paragraph .22 of the Accounting Principles Board opinion on reporting the results of company operations. 85

The disclosure requirement calls for the presentation of the resulting effects (both gross and net of applicable income tax) on the net income for the year in which the adjustments are made. When financial statements for a single period are presented, the adjustment shall be made on the opening balance of the retained earnings and on the net income of the immediately preceding period.

When comparative statements are presented, the disclosure should include the effects for each of the periods included in the statements.86

Statement of Changes in Financial Position

Expenditures for pollution abatement and environmental damage control activities shall be disclosed separately in the statement of changes in financial position. These expenditures (depreciation as adjustment to income), include the acquisition of physical facilities as well as all the cash outlays for costs and expenses enumerated earlier. Corcoran and Leininger made a similar proposal:

In reporting the exchange of financial resources between the firm and its environment, much of the information would be contained in a flow of funds statement. Such a statement might be accomplished better by adding new detail to the present sources and uses of funds statements than by including a funds statement as part of the environmental report. Several items that could be detailed would be a descriptive list of taxes paid, voluntary contributions made by the firm, investment made both for pollution control and environmental improvements to work stations (i.e., dust and sound control), and financial aid extended to various social causes.87

Earnings per Share Computation

In proposing the inclusion of earnings per share compu-
In the face of the income statement, the Accounting Principles Board justifies it in this manner:

... the significance attached by investors and others to earnings per share data, together with the importance of evaluating the data in conjunction with the financial statements, requires that such data be presented prominently in the financial statements. 88

Presumably, the same justification was advanced to support the proposal to present earnings per share amounts for extraordinary items.

In recent years, the literature with respect to the social performance of corporations suggests that expenditures for social causes be related in terms of percentage to sales and other similar statistical comparisons. Similarly, corporate contributions are evaluated in terms of percentage to gross income. The latter appears to have been influenced by the tax allowance of 5 percent based on gross income.

The real issue, however, is the significance and the usefulness of these percentages insofar as gauging the social sensitivity of a particular company. For instance, the percentage of the costs of social activities to sales will certainly create an illusory index of sensitivity to social demands because such costs has to reach millions of dollars before a modest percentage relationship could be attained. Similar situation may arise with respect to the percentage of actual contributions to gross income.

Therefore, to remedy the misleading inference that may result from these percentages, this study proposes that a computation of a per share costs of social activities be computed in the face of the income statement similar to the per share computation of extraordinary items. The per share figure will provide a better view of the company's social involvement for it shows the amount of profits per share which the company committed to social causes. Consequently, this per share costs of social activities could stimulate a more creative justification for pursuing them. For instance, if the net income per share before the cost of social programs is $2.00, and the per share cost of social activities, less the applicable income taxes is $.30, management could tell its stockholders that the earnings of their company is $1.70 in dollar terms, plus $0.30 earnings (enjoyment) of clean air, clean water, and/or peaceful society, plus assurance (earnings) to conscience in terms of reducing injustices in the American society.

A simple presentation of this proposal is shown in Appendix C.

Summary

This chapter has dealt with the accounting and the reporting aspects of corporate social programs, and cited several reasons to justify the activity. It was concluded that the traditional financial statement models of the accountant are still the best media to report the social activities of the enterprise.

As a background concerning the progress of reporting
these social programs in the traditional reporting models of the accountant, this section of the study has reviewed the findings of major works providing into the matter. The works of Norman Pope, Williams, Caldwell and Needles, and the accounting firm of Arthur Andersen & Co. have been considered. These studies have found that, although considerable progress has been made, the reporting practice of reporting these social activities is purely narrative, generally in the president's letter to the stockholders and in the body of the annual report.

Several approaches to the social audit have been considered. It was recommended that this area of activity be taken by the accounting profession as a special activity and that the corresponding report be considered as a supplement to the financial reports of the enterprise. Accordingly, it is suggested that the accounting profession should find a suitable methodology so that the cost of social programs be reported in the traditional financial statement models of the profession.

In the search for a methodology for costing these social activities, the attention of the accounting profession has been directed towards the conduct of a social audit. As a result, the accountants overlooked their fundamental responsibility for accounting and reporting the relevant data concerning these social activities in their traditional reporting model. The discussion concluded that the accounting profession has adequate techniques in accordance with generally accepted accounting principles to account and report on these social activities.
Suggested in this study as a costing methodology for these social activities is input costs, that is, the dollar value of the corporate resources committed in pursuing these activities. This costing methodology excludes opportunity cost.

For a meaningful reference to the costs of social programs, a system for classifying them has been offered. As to intent or purpose, the cost may be preventive or refurbishing; as to the manner by which corporate resources are committed, the cost may be direct or indirect commitment of resources; and as to the move or driving force which induces the firm to undertake certain social programs, the cost may be voluntary or involuntary.

The resources committed to pollution control and environmental conservation programs and to the other social programs of the company have been identified. Using input cost as a costing methodology, the translation of these resources into dollar terms was discussed.

A detailed discussion was made concerning the accounting for costs of social programs. It was concluded that the accounting problem involved with these costs is not as complex as it appears to be. Their accounting treatment is not different from the accounting for costs and expenses incurred by a company in its regular operation.

The reporting problem posed by these social activities has been considered. Specific disclosures have been suggested for pollution abatement and environmental damage control facilities in the balance sheet, income statement, statement of capital and retained
earnings, statement of changes in financial position, and in the computation of earnings per share. Similar disclosures were outlined for contingent liabilities, extraordinary items, discontinuance of the operation of a business segment, and the cost of other social activities of the company.

The next chapter will look into the feasibility of applying the proposed accounting and reporting methodologies discussed above in an actual corporate setting.
CHAPTER VI

AN APPLICATION OF REVISIONS TO EXTERNAL REPORTING
MODEL -- A FEASIBILITY STUDY

The preceding chapter has discussed the accounting and reporting aspects of corporate social activities relative to the external reporting responsibilities of the corporation. Also discussed were certain preliminary considerations such as the need for reporting these social activities in the traditional reporting model of the accountant, the current reporting practices for such activities, social audits and the approaches for conducting them, the measurement problem and the proposed methodology for quantifying the resources committed to these social activities.

The current chapter will investigate the feasibility of applying, in a real world situation, the proposed measurement methodology and the accounting and reporting procedures discussed in Chapter V. In addition, this chapter includes a certain amount of discussion designed to direct the attention to the importance and usefulness of these procedures for internal decision making.

Background of the Study

This portion of the study was originally conceived as a case study of a few companies which would be willing to participate in applying the costing methodology and the accounting and reporting procedures for corporate social activities developed earlier. The
main objectives intended to be accomplished were: (1) to measure or quantify in dollar terms the resources committed by the corporation in pursuing social goals using the input cost methodology proposed previously; (2) to identify and classify the cost of social goals for future frame of reference; (3) to ascertain the accounting treatment of these costs; (4) to use the amounts quantified, accounted for, and classified above to test the efficacy and the applicability of the proposed revisions to the traditional reporting model of the accountant.

Unfortunately, this study met serious difficulties in soliciting participation from industry. The companies with which this writer discussed the details of the study and which signified their intention to consider the matter seriously during the national symposium of the National Affiliation of Concerned Business Students (NACBS), in Berkeley, California in November, 1972, declined from participating in the case study. One large West Coast utility company declined because it has been subjected to various previous studies in the area. A large bank was requested to participate, but implicitly refused the request. It, however, furnished this writer, with specific instructions not to be quoted, copies of its cost studies of the various social activities of the bank. Unfortunately, these data were not usable for the purpose of the study.

The situation concerning this type of study has perhaps been placed in a brighter perspective by the answer received from a multinational chemical company. At the outset, the company was enthusiastic about the study and indicated that it has a "reasonably
good data base on our work in environmental improvement."¹ When specifically asked to participate in the study primarily because of the existence of such data base, the company wrote:

We have given considerable thought as to the extent we can help you in defining the costs of our pollution abatement work. I'm afraid that the conclusion is that this help must be limited for reasons I will explain.

My judgment is that our data base is limited. We, and I suspect others in /the/ industry, just do not have accounting systems set up to produce the data required. We have made a stab at it as you know. But even from division to division situations and goals vary. We do not keep our books in any way that enables us to readily identify all pollution abatement numbers or consequences.

From past experience we know we have to rely primarily on engineering estimates and project analysis to come up with cost information. These are time consuming and costly tasks so we do not do them for others. Also, we will not supply information we do have in detail because some of it is in the trade secret category.²

Conceivably, the excerpts from the letter quoted above could be interpreted as unwillingness to participate due to the inadequacy of existing records, let alone the cost involved, or unwillingness due to some other reasons which could be the subject of speculation. The 1972 Committee on Environmental Effects of Organization Behavior of the American Accounting Association speculates along these lines when it discourages accountants from measuring and reporting on the

¹ From the letter to this writer. Further details will not be provided in order to conceal the identity of the company.

² Ibid.
total social costs of damage to the environment as a result of organizational behavior. It specifically states that "it is difficult, if not impossible, to obtain objective monetary measures of total environmental damage" and "most firms probably would not voluntarily reveal the total costs to society of environmental damage due to their operations, even if the costs could be measured and allocated reasonably."³

Faced with this problem, this writer applied to participate in the "Scholar Program" sponsored jointly by the Ford Foundation and the NACBS in cooperation with several participating companies, proposing to measure in quantitative terms the resources committed to pursuing corporate social activities. This proposed research area was selected from among the numerous applicants all over the nation as one of the six projects of the NACBS.⁴ A large oil company⁵ agreed to be the subject of this study.

Objectives of the Study

As a result of the above situation, the study has been


⁴ The reports of the "Scholars" are now being reviewed. All of them will be presented in the second national symposium of the NACBS in early October 1974.

⁵ Subsequently referred to in this chapter as "the Company."
confined to a single company. Fortunately, this Company has been widely acclaimed as a leader in social responsiveness. It has a wide range of social activities, including an intensive implementation of its pollution abatement and environmental conservation policy which could provide a reasonable coverage of pervasive social activities being undertaken by companies in various industries.

However, in the course of the preliminary work to identify the various social programs to be studied and the corresponding corporate resources committed, certain constraints developed. It was decided that the quantification of the costs of these social activities be undertaken for the calendar year 1974, to be reported on March 1, 1975, and every March 1 thereafter. As a result, the case study approach which was originally conceived for this portion of the inquiry has been reduced to a mere feasibility study to prove whether or not the costs of social activities could be quantified in terms of input costs without unnecessary burden to the various departments concerned. Moreover, two other original objectives were deemed attainable, that is, the identification and the classification of costs of social activities, and the review of the accounting treatment of these costs. Needless to say, under the circumstances, the determination of the total dollar values of the resources committed to social activities, and their presentation in the traditional reporting model of the accountant cannot be accomplished.

Methodology of the Study

The methodology used in the feasibility study consists of the following:
(1) A combination of the three main approaches to conducting a social audit, namely, inventory method, program management approach and cost-benefit approach. This combination of methodologies was designed to identify the social activities to be studied and to evaluate their accomplishments in relation to the goals set for each program, and to some extent, in terms of the benefits derived from it.

(2) An interview with the various personnel and departments involved in the social programs identified above to ascertain the feasibility of quantifying and reporting these costs as required, the possible problems that would be met, and to elicit the purpose(s) of a particular program, the reason(s) for doing it, and the benefits derived from the program.

(3) A follow-up interview of selected personnel or department involved in these social programs to ascertain that the purpose of the study and the costs to be included have been fully understood, and to test whether or not the costing methodology would be feasible in actual costing exercise. Accordingly, this aspect of the study could uncover and/or anticipate problems in this respect.

As the company counterpart for the study, the Controller's Department assigned a staff from the Systems and Methods whose responsibility was to write the initial report and the reporting format for these costs. Another staff member from the Information Systems and Management Sciences was assigned to take the responsibility of writing the formal instructions concerning the preparation and compliance with this reporting requirement.

The Feasibility Study

As a starting point of the study, a framework for analyzing the company's social programs has been developed. On a broader sense, the framework attempts to focus the study's attention to identifying,
at the outset, all the social programs being undertaken on a company-wide basis. As a result, the following major social programs undertaken in conjunction with U.S. operations were identified and defined as the subject of this study:

- Air pollution control
- Water pollution control
- Land and water conservation programs
- Minority and women's hiring and promotion
- Minority enterprise program
- Minority purchasing
- Company contributions
- Environmental conservation and social policy
- Community affairs

In a narrower sense, the framework attempts to set up a cost profile for each social program identified above. It starts by defining the goals and objectives of the social project, followed by the identification of the type of company resource(s) committed, attaching of monetary values to such resources committed, and the evaluation of the efficiency of the program in relation to its established goals as well as a comparison of the budgeted resources for the program and the actual use of such resources. Since the study assumes that the project is the Company's first attempt to look at its social programs on a coordinated and comprehensive basis, the framework provides for a critical review of the accomplishments of each program, and the program itself, in terms of its contribution to the accomplishment of the overall corporate social goals. This critical review may result in either (1) the discontinuance of the program; (2) the modification of some of the objectives of the program; or (3) the expansion of such program along with the increase of the resources necessary to accomplish the expanded goals and objectives.
This framework described above is presented in Figure 7, and the step-by-step approach to setting up a cost profile for water pollution control program and minority enterprise program is presented in Appendices D and E, respectively.

The definition of costs — input costs — has to be redefined to fit company conditions, and to direct the efforts of the study to reasonably large cost items or components. In going through the input cost components of social programs, other than air and water pollution control programs, it was decided that the apportionment of personnel time, that is, between company matters and social program activities, shall not be done, at least at the start, because of the difficulty of estimating such time, and quite often the personnel time spent in some programs are negligible. This means that the dollar value of an employee's time shall be included only when he devotes 100 percent of his time to the program. However, the study allows certain flexibility in this case. For instance, in one program where more than one personnel member was involved, the department in charge of the social program proposed to make an estimate of the total time spent by all the personnel involved. Consequently, a flat rate percentage overhead representing employee benefits, as determined by the Company, shall be added to salaries included in the above costs. It was likewise decided that for this initial project, no departmental overhead (other than salaries and benefits) shall be allocated to the social program. However, it was subsequently ascertained that the department overhead may either be 100 percent assignable to the social program
Inventory of Socially Relevant Programs

Defining Program Goals and Objectives

Identifying and Defining Resources Committed

Attaching Monetary Value to Resources Committed

Evaluation of Program Effectiveness

Planning and Budgeting

To Corporate Social Programs Decision Model

Table 7

A Framework for Analyzing Socially-Relavant Programs
or if subject to allocation, the resulting amount is immaterial or negligible.

In the case of pollution abatement and environmental conservation facilities, the capital outlays worldwide are being accumulated in the Controller's Department, and subsequently reported to the Manager of Environmental Conservation. For facilities or equipment with built-in pollution control feature, the procedure is to apply the guidelines developed by the American Petroleum Institute for determining the portion of the cost of the equipment or facilities which applies to pollution control and environmental conservation. In addition, the guidelines provide a formula for estimating the administration and operations and maintenance expenses for these facilities. Experience indicates that the resulting expenses amount to about seven percent of the total investment in environmental control facilities.

The computation of the depreciation on the above equipment may pose a problem during its initial determination since the company's records do not allow for the separate computation of such depreciation. However, reasonable figures could be derived by estimating them through the guidelines provided by the American Petroleum Institute.

The interview phase of the study requires three days of interviews with the various personnel and departments involved in the Company's social programs. The interview centered heavily on the

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6 American Petroleum Institute, op. cit., p. 3.
feasibility of generating the cost figures without adding an unnecessary burden on such personnel and departments concerned. Questions were asked concerning the extent of undertaking the program and the perceived benefits derived from them.

As a result of this study, a simple management information system has been developed. Although the system is not integrated into the accounting system, it is believed to be capable of generating the cost data concerning these social programs. Under the system, each department or personnel involved in undertaking the program has the primary responsibility of identifying and reporting these costs to a designated coordinator. Initially, the coordinator is the Director of Corporate Responsibility of the Company.

A draft of the study report was written by the Systems and Methods staff, and was circularized for comments to the interviewed program administrators. Consequently, the comments were incorporated in the report, and was made part of the Company's Procedures Manual. Being drafted by the Information Systems and Management Sciences staff is the applicable instructions for the annual preparation and reporting of these costs. The initial report will cover the calendar year 1974, to be submitted on or before March 1, 1975.

A follow-up interview of a number of social program administrators was made to ascertain that the objectives of the study were fully understood by them and to thresh out possible problems that may be encountered in generating these costs. Moreover, the costs of undertaking two programs -- pollution abatement and environmental conservation and minority enterprise program -- were calculated.
As a result, an elaborate costs and expenses report (See Appendix F) patterned on the traditional income statement for the latter program was formulated. Also investigated was the feasibility of subjecting this program to a strict cost-benefit analysis proposed under the social audit. (This point will be elaborated later in this chapter.)

Presenting a burdensome problem in these test calculations was the computation of the applicable depreciation on the pollution abatement and environmental conservation facilities. The reason is that these facilities are scattered and buried in the various functional classifications of the vast company facilities. Therefore, specific identification of these pollution abatement and environmental conservation facilities may be very costly or perhaps, physically impossible. The problem, as well as a suggested approach to its solution, was brought to the attention of the Director of Corporate Responsibility. Likewise, the untested overall efficiency of the social cost generating system was underscored because the system will be implemented only starting the 1974 operation of the company.

Findings of the Feasibility Study

The feasibility study has uncovered several interesting points which would be useful in the future discussion on the accounting and reporting aspects and other related matters concerning corporate social activities. However, these findings have to be tempered by the fact that the study is limited to a single company, which may not even be representative of all firms in the industry.
These points will be discussed in the remaining pages of this chapter.

**Identification and classification of costs of social programs** - On a more theoretical and speculative basis, the classification of costs of social programs have been identified and discussed in the preceding chapter. These cost classifications appear to correspond with the costs identified for water pollution and minority business costs identified for all the social programs studied. For illustrative purposes, the costs identified and defined for water pollution and minority business enterprise are shown in Appendices D and E, respectively. However, refurbishing costs as a classification in itself may not be common in the Company's operation or perhaps, in the operation of the entire oil industry because the restoration of a wellsite after the equipment items are removed is an integral part of the company's operation. In addition, it appears that to go into this type of classification may result in a humanly impossible problem of cost allocation. For instance, a bulldozer is used for many purposes in the daily operation of the Company including (perhaps once a year), its use to level the ground in an abandoned wellsite. Obviously, a system of cost allocation can be worked out in a theoretical sense, but on a practical and operational perspective the whole allocation scheme may not be feasible. As a consequence of integrating the environmental conservation program into the operation level of the company, the significance of the environmental restoration clause in certain lease contracts upon their termination is not to the company but to the other contracting party.
The refurbishing characteristics of cleaning up an oil spill is another interesting point along these lines. The Company maintains oil spill cleaning equipment of several million dollars, yet in the history of the Company's offshore operation, no major incident has been experienced. The practice of the Company (and in the industry) is to account for these activities as part of its daily chore, that is, observing diligently the various safety standards in its production activities necessary to prevent an oil spill. Therefore, in the absence of an oil spill, the oil spill cleaning equipments are left idle, but their maintenance costs are charged to current operation. Obviously, the matter is analogous to the case of fire extinguishers stored in certain strategic places in the company premises.

Cost measurements - As noted in the feasibility study, the problem of generating and gathering the costs of social activities is a function of the adequacy of company records, and a reasonable system of cost allocation. However, these problems should not be a hindrance in deciding whether or not to undertake a similar costing project. The Company under study started some years ago to maintain adequate records for its pollution abatement and environmental

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8 The commitment of management to do it must not be overlooked. In fact, this feasibility study was conducted under a blanket endorsement by the company president to pursue these social projects. This made the completion of the project easier because it had the complete cooperation of the program administrators.
conservation equipments but not on the social programs being undertaken to date. The former is made possible by the continuing surveys made by the American Petroleum Institute concerning the individual company's capital outlays in pollution abatement and environmental conservation facilities.

As a starting point, the program administrators took pains in making reasonable estimates of the time spent in pursuing these programs as well as the direct costs involved in them. In effect, the Company utilizes its learning curve in an evolutionary process to arrive at reasonably accurate cost figures for these social programs. In a memorandum to the company president, the Director of Corporate Responsibility put this process within two years, after which the accuracy of the costing system and its value could be assessed.

This writer proposed to management that the program administrators should start accounting for their time spent in undertaking these programs on a monthly basis (preferably, as a percentage to total working time) to insure the accuracy of the departmental costs and overhead allocation at the end of the year. Likewise, it was suggested that after sufficient experience and knowledge are acquired from the costing process, the system shall be integrated into the accounting system so that the whole social program costing process be made part of the sophisticated management information system of the Company rather than just an off-system additional burden to line executives.
Accounting for and disclosure of social programs - The accounting for the costs of the Company's social programs are consistent with the accounting treatment proposed in the preceding chapter. Perhaps, this is pervasive in most companies because, as in the company under study, the cost of undertaking these programs are buried in the overall costs and expense of doing business. Obviously, the situation is the result of the novelty of the importance attached to these social activities of corporations and the lip service given by the accounting profession to quantify these costs.

Since the conservation and restoration programs of the Company are an integral part of its daily operation, the costs of undertaking them is part of the Company's production costs. Similarly, the restoration costs incurred by the Company after its operation in a particular area is terminated are accounted for on the same basis. Finally, the costs of cleaning up an oil spill is likewise charged to production cost. The latter, of course, may not be an appropriate accounting treatment in accordance with generally accepted accounting principles if such cost is material arising from a major oil spill.

Regarding the disclosures on its social activities, the company is rated highly by the Council of Economic Priorities. However, this information does not come through the financial statements in the manner suggested in this study. Therefore, it was suggested to management that the Director of Corporate Responsibility should work with the Controller's Department to include a
footnote in the company's financial statements regarding its social activities. In line for this footnote is the company's pollution abatement and environmental conservation activities whose records are adequate to generate the needed information.

**Cost-benefit analysis** - In an effort to gain an insight into a cost-benefit analysis of these social programs in a manner proposed by social audit advocates, the study attempted to analyze the cost and the corresponding benefit derived from the Company's minority enterprise program. This program was specifically selected because the program administrator expressed concern that as soon as the cost of undertaking it would be available, management might be overwhelmed by the cost and eventually decide against continuing the program. He solicited suggestions in measuring its benefits to be reported together with its cost.

Considerable time was spent in analyzing the problem, and the initial result was that there was no correspondence between the input (cost) and the output (benefits) of the program. To state the findings in a more picturesque manner: The situation is analogous to the parents who supported their child to go to college and obtain a degree. The child gets the monetary rewards and everything that goes with it in both tangible and intangible terms. Society is benefited in the process, while the parents reap the satisfaction of being instrumental to their child's success, and perhaps, in reducing delinquency and crime in the streets. Of course, the parents and the whole clan may be hailed as a good or as a socially responsible family (essentially reputation or goodwill).
Translating this type of cost-benefit in the language known to a businessman (and in economics), i.e. profits to the company, appears to be a real dilemma. For instance, if helping a minority business survive competition in the market creates goodwill for the company, how would this be expressed, or measured in profit terms? Is the promise of a peaceful community enough to motivate the continuance of the project?

Faced with this problem, the study suggested that top management define, in both conceptual and pragmatic terms, the phrase "benefit to whom." If the term is defined as benefit to the Company, the problem is insoluble, given the state of the art. This conclusion has been tested in the case of the Company's minority purchasing program. Asked about the benefits derived from his program, the line executive involved in it answered to the effect, that by helping a minority supplier, his program creates additional market for gasoline and other petroleum products of the Company.

If "benefits to whom" is defined from the standpoint of the recipients, which may be a specific group or the society at large, the benefits derived by these groups may yield to some sort of measurement; quantitative and/or qualitative. Therefore, measurements analogous to the social indicators suggested by social scientists may prove useful.

Accordingly, in an attempt to gain an idea as to the benefits of this program, an indicator-type benefit analysis for each minority business helped as shown in Appendix F has been
suggested to the administrator of the minority enterprise program.
A consolidated report based on these data may be prepared for the entire program.

In perspective, without these definitive notions of the phrase, "benefits to whom," the reality and the operational feasibility of the so-called social audit may be seriously questioned.

Conclusion of Feasibility Study

Based on the limited scope of the feasibility study, and on the assumption that the nature of the costs incurred in undertaking these social activities are identical (that is, a minority enterprise program in one company may not be significantly different from a similar program in another company), this study concludes and proposes that:

(a) Corporate resources committed to social activities could be quantified based on the input cost methodology proposed in the preceding chapter.

(b) The primary difficulty in the quantification process is the availability and the adequacy of company records. However, the quantification shall be undertaken on an evolutionary process; making provisions for experiencing and experimenting procedures and techniques to fit individual company circumstances.

(c) The accountants, contrary to the recommendations of the 1972 Committee on the Environmental Effects of Organization Behavior of the American Accounting Association should attempt to measure, based on the input cost methodology proposed above, and report, in accordance with the reporting framework discussed earlier, on the social activities of the corporate enterprise.

(d) The costs of these social programs can be accounted for and reported based on existing generally accepted accounting principles.
(e) The problem of cost allocation between the regular operation of the company and undertaking the social program is not new for the accountants. However, experimentation is needed to find the most reasonable allocation to insure the reliability of the resulting cost figures.

(f) The accounting organizations, especially the American Institute of Certified Public Accountants and the American Accounting Association should provide leadership in this respect. To insure the comparability of the information that may be disclosed concerning these social activities, the accounting associations should look into the possibility of formulating standard disclosures concerning the matter, preferably, on an industrywide basis.

(g) Social audits may not be operational in the foreseeable future given the state of the art. However, the problems identified with it may be minimized if the phrase "benefits to whom" is defined in both conceptual and pragmatic terms.

(h) No new reporting requirements are necessary to satisfy the needs of internal users. Both quantitative and qualitative information may be provided for this group of users. The latter may take the form of the various details in Appendix F.

Attestation

The feasibility study did not indicate that the attest function of the accountant would be jeopardized or made more complicated as a result of reporting in the traditional financial statement models the cost of social programs. Conceivably, the emphasis of the attest function would center around two significant areas which are basic in this accounting function. First, is the verification regarding the existence of the social program as well as a review and evaluation of the reasonableness of the cost allocation.
methodology used in ascertaining the cost assignable to it. Second, is the accent on relying extensively on the opinions of other experts either in-house or from outsiders. A common example is in the case of contingent liabilities which the accountant relies heavily on the opinion of the company's legal counsel. Another example which may be a distinct characteristic of attesting to the costs of social programs is the reliance on engineering representations and estimates. For instance, in identifying the portion of a new equipment devoted to air pollution, the oil industry relies on the guidelines prepared by the American Petroleum Institute. The customary procedure to verify the allocation is to seek the opinion of consulting engineers or the accounting firm's experts in its management advisory services department. This is reinforced by direct correspondence with the American Petroleum Institute concerning the reasonableness of its guidelines.

Internal Reporting

In the preceding chapter, it was argued that the proximity of management to the operations of the company makes its decision model susceptible to both quantitative and qualitative information. Implicit in this argument is that these qualitative data are needed and that the accountant must be involved in providing them. Bringing the issue to the level of corporate social programs, these qualitative data, while they may be important, are not critical at this stage to management decision-making. There are two main reasons offered to support this contention. First, management appears to be more
concerned, at least at this point, with "what it takes" to be socially responsible. Put it in another way: how much will it cost to undertake a minority enterprise program? Accordingly, it would not be surprising if the decision whether or not to undertake this project depends on the funds required. Invariably, the situation fits into the satisficing tendency of management in the face of competing goals and in an era of scarcity which necessitate rationing of available corporate resources. In effect, the decision to pursue various goals, especially social goals, is a function of available funds (not primarily the benefits) that management could spare or divert from the mainstream of the profit objective and still realize a return on investment which satisfies the corporate constituencies.

Second, the issue on qualitative data has to be clarified as to the social programs to which they apply. For this purpose, the social activities of multi-million manufacturing organizations can be grouped into two broad classifications: (1) pollution abatement and environmental conservation activities and (2) those referred to throughout the study as other social programs or activities, such as insuring company properties with minority insurance companies, minority enterprise programs, affirmative action to hire minorities and women, and similar programs.

For pollution control and environmental conservation activities, most of the data that management would be working with are hard facts. The standards set by governmental authority are expressed in quantitative terms including the projected reduction
in air and water pollutants. In the case of other social programs, the issue of qualitative information becomes relevant in relation to the intended benefits of these programs. However, the feasibility study indicates that even the company under scrutiny which is far advanced in advocating performance measurements to institute rewards and penalties, is just beginning, as a result of this study, to look at the costs of pursuing these social programs in relation to their predetermined objectives. Unfortunately, most of these social programs do not have specific objectives other than the pervasive notion that social programs have to be undertaken because it is the right thing to do, and the company president has made a speech committing the company to engage in these affirmative actions. Moreover, as suggested earlier, any exposition on benefits relative to a social program has to define the phrase "benefit to whom." If the term is conceived as benefit to the company, the problem of qualitative data becomes serious and the data itself would be fraught with vagueness. If the phrase is defined as benefits to the corporate constituencies, including the society at large, certain indicators may be developed as part of these qualitative data. In this case, the whole issue is elevated to the problems of the social audit, the operational application of which has been questioned previously, given the state of the art.

The question that has been raised as a result of the feasibility study is whether or not these input costs would be useful to the Company's decision-making process. Of course, the answer is
obvious. For the first time, the company will know how much it takes to be socially responsible in the context of its social involvement. The Company may choose to discontinue the most expensive projects, and concentrate on the cheaper ones. In the case of pollution control and environmental conservation activities, management would know the cost of complying with the minimum or maximum standards. Decisions based on the following examples of alternatives may be thoroughly evaluated:

1. too expensive to comply with the standards, the plant has to be shut down immediately.
2. shut down the plant at the deadline of compliance and perhaps, make plans to set up a new plant or factory with the most modern pollution control equipment.
3. plan compliance below the minimum standard, and pay the penalty.
4. comply with the standard and establish goals of compliance.

Summary

This chapter discusses the feasibility study undertaken with the cooperation of a large oil company to ascertain the applicability of the input cost methodology for costing the resources committed to the company's social programs. Two other objectives of the study were discussed: (1) the identification and classification of the costs of social programs and (2) the accounting treatment of these costs. Because of the problems encountered in the feasibility study, the actual costing of all social programs and the presentation of these costs in the traditional financial statement models of the
accountant was not undertaken

The study was completed through personal interviews with the line managers in charge of the specific social programs of the Company as well as a follow-up interview of certain program administrators to elicit their understanding about the project and to thresh out possible problems that may be encountered in the actual costing of all social projects for the calendar year 1974.

In addition, the costs of certain projects were calculated to reinforce the conclusion that the proposed input costing methodology will be workable in actual situation.

As a result of the study, a simple management information system has been developed to generate the costs of the Company's social programs.

The serious problems encountered in the study were the inadequacy, and in most instances, the non-existence of appropriate records. The latter is particularly true with affirmative action programs of the Company. Adequate records, however, are maintained for pollution control and environmental conservation projects. The findings of the study are:

(1) The nature and the classification of costs for social projects discussed in the preceding chapter were in agreement with the nature and the actual cost classification defined in the feasibility study.

(2) In attempting to measure these costs, the study relies heavily on the estimates of program administrators. The Company subscribes to the evolutionary process of generating these
costs, and sets two years as its goal of attaining reasonable accuracy in the resulting cost figures.

(3) The Company follows the pervasive reporting and disclosure procedures in its annual report. Such disclosure is found in the body of the annual report.

(4) There seems to be no correspondence between the inputs (costs) and outputs (benefits) regarding these social activities. This makes cost-benefit analysis a tremendous problem. To mitigate this problem, it might be useful to define "benefits to whom" in both conceptual and pragmatic terms.

The feasibility study concludes that the quantification of corporate resources committed to social activities can be accomplished based on the costing methodology suggested in the study. It suggests that accountants should measure and report on the social activities of the enterprise. The reporting procedure established earlier is suggested for this purpose. Other conclusions and recommendations are specified in the study.

The problems of attestation has been discussed. The conclusion is that the accountants have sufficient auditing procedures and techniques to handle the situation.

The problems of internal reporting for management decision-making was discussed with regard to certain relevant issues. It was concluded that qualitative data may be provided to internal decision makers relative to these social programs. However, the need for such qualitative data is not critical, at least at this stage.
CHAPTER VII

SUMMARY, CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

This chapter contains the summary, conclusions, and recommendations for future research based on the results of the study. The discussion proceeds by presenting the primary and secondary objectives of the study followed by the areas of research necessary to accomplish the objectives. The remainder of the chapter is devoted to the summary, conclusions, and suggestions for future research.

Objectives of the Study

As set forth in Chapter I, the primary and secondary objectives of this study are:

Primary objective

To measure in dollar terms the corporate resources committed to social activities, to investigate the accounting treatment of costs of these resources in accordance with generally accepted accounting principles, and to formulate a reporting framework for such costs in the traditional financial statement models of the accountant.

Secondary objectives

1. To formulate a social and economic rationale for corporate involvement in social issues, and to investigate the related issues of the quality of life as well as the economic aspects of corporate social responsibility.
2. To investigate the issues relating to the social responsibilities of the accountant, and to formulate justifications for expanding the responsibilities of the accounting profession in the light of the rising expectations of society.

3. To provide a framework for establishing a contemporary accounting theory which is responsive to the dynamic demands of its environment.

Approach to Accomplish the Objectives

To accomplish these objectives, a systems approach is used to provide an understanding of the relationships among the interacting systems and subsystems that contributed to the problems under study.

The first area covers an analysis of the current issues of corporate social responsibility and the quality of life resulting from the interaction between society and the modern corporation. This accomplishes the first secondary objective, and the analysis is presented in Chapter II, Part I.

The second area consists of an investigation of the interaction between the accounting profession on the one hand and the modern corporation and society on the other which gives rise to the current issues of the social responsibilities of the profession. This analysis accomplishes the second secondary objective and the discussion is presented in Chapter III. In addition, this area of research provides a basis for the formulation of an accounting framework upon which a contemporary accounting theory can be developed. This satisfies the third secondary objective, and Chapter IV
of Part II is devoted to the discussion of the results of the investigation.

The third and fourth areas of research were designed to accomplish the primary objective of this study. The former deals with the costing methodology and the theoretical and practical aspects of accounting and reporting problems of the costs of social activities. The investigation ultimately results in the formulation of a framework for reporting these costs in the traditional reporting model of the accountant. The latter area concerns with the operational applications of the costing methodology and the accounting and reporting techniques developed above. This was accomplished through a feasibility study conducted with the cooperation of a large oil company. The results of the above investigation are discussed in Chapters V and VI.

Summary

Considerable space has been devoted by this study to put in perspective the changing environment of business today. To attain a full grasp of the dynamic aspect of this environment, its major interfacing elements are depicted in Figure I. A key point underscored in this analysis is that society's will is supreme. Society creates the situation, the atmosphere or the basis for the interaction among its segments. In this context, society and all its segments are part of a system, where the latter are subsystems of the former. As such their actions must be consistent with the wishes and purposes of society, the main system, and any deviation from them renders the existence of a subsystem untenable.
In recent years, society has been concerned with the quality of its life. This situation is ironical. While technology keeps material things flowing incessantly into every household, the good life promised by them is short from being realized. The situation is analogous to a dictum in gambling: What one gains the other losses." The economist-philosopher Mishan extended this dictum further by arguing that as progress is "being unrolled by the foot, it is simultaneously being rolled up behind us by the yard." Unquestionably, for every source of energy extracted from the ground, the aesthetic value of the surroundings suffers, for every convenience good added to the supermarket shelves, the refuse problem and the air and water pollution dilemma are aggravated.

But the problem is how to measure the quality of life. In a democratic society like ours where every individual has the right to pursue his own values and desires, the concept is rendered nebulous. Consequently, this study offers a definition of quality of life as the state of affairs (or one's sense of well-being) of society as perceived by a person or groups of persons. This definition underscores the idea that a person's well-being depends on his perception of reality, which may be faulty. To measure quality of life, this study proposes that an index of satisfaction about the health, happiness, well-being etc. of the nation can be developed through properly designed opinion surveys at certain points of the country.

The concern for the quality of life leads society to demand from every institution to help in its improvement. To a greater
extent, however, the demand is directed towards business, particularly, the modern corporation, for it has the power, the intelligence and the resources to pursue this goal. In addition, the corporation is considered as the prime contributor to the deteriorating quality of life of society.

The problem boils down to the role of the modern corporation in society, and the surrounding issues are debated around the concept of corporate social responsibility. Two schools of thought surfaced in this controversy; the "managerial" view which recognizes the role of business in attaining social goals and the "classical" view which holds that the business of business is profit. As the concept of corporate social responsibility is debated, most enlightened corporate managers who accepted the responsibility are asking for a definition of the boundaries of this new role thrust upon them. Consequently, a conceptual and operational definition of the concept is offered in this study. This study accepts the conceptual definition of Keith Davis to the effect that the concept of corporate social responsibility refers to the "businessman's decisions and actions taken for reasons at least partially beyond the firm's direct economic or technical interest." The operational definition offered in this study is built around three considerations: (1) to define the concept in terms of compliance with law; (2) to define it in terms of activities over and above the requirements of the law; and (3) to define corporate social responsibility in terms of any voluntary activities
in response either to public pressures or to the sensitivity of management to social concerns.

These considerations have provided an insight into the boundaries of an operational definition of the concept but they do not provide a basis for setting up program priorities. The study develops these guidelines and is made part of the operational definition of corporate social responsibility. Consequently, the concept is operationally defined as referring to the businessman's decisions and actions, voluntary or in compliance with law, without the expectation of direct economic gain, for the well-being of society or for one or more of its constituents. Such decisions and actions are determined by such criteria as (1) area of disturbance; (2) area of operation; (3) existence of the necessary expertise in the company to do the job; (4) impact on the firm's immediate location; and (5) impact beyond the location of the firm. The application of these criteria is presented in Figure 2.

The study believes that a social and economic rationale for corporate social responsibility has to be developed so that corporate managers have a basis for their actions. The foundation of the social rationale for the concept is that business is a social system with related subsystems composed of the corporation, managers, employees, creditors, suppliers, customers and the general public. Consequently, social profiles were developed for the corporation and the corporate managers.

The economic rationale for corporate social responsibility is built around the context of short- and long-term profits. Obviously, the tendency to maximize short-run profits may run
counter to the long-run profitability of the company. This study has presented arguments that those managers who oppose the concept are more preoccupied with short-term profits. Therefore, they overlook the long-run implication of corporate social responsibility.

A much broader implication of the concept has been discussed. Social scientists and business observers believe that capitalism and our economic system are still evolving.

Finally, the study suggests that the action and response program of the company shall be a part of its strategic planning. A planning model for this purpose is presented in Figure 3.

The economic implication of the concept of corporate social responsibility has been presented. Discussed prominently in this section of the study are the private costs and social costs of the activities of a business entity. In its production activities, a business unit accounts for private costs in its decision model. However, social costs are left to the care of society.

The exclusion of social cost from a firm's decision model causes an illusory index of efficiency and profitability among business units. The reason is that certain activities are profitable from a private cost standpoint but unprofitable from a social cost point of view, or vice-versa. To eliminate social cost completely may not be possible, however, its effects could be minimized by internalizing or introducing it into the decision model of the enterprise. Three methods are proposed and discussed in this study.

An interesting controversy exists between the environmentalists and the economists regarding continuous growth and maximi-
zation of productivity and profits. The former contends that continued growth has certain serious consequences; the latter argues that growth and productivity are needed for a greater distribution of wealth and income. Unfortunately, the controversy connotes an "either-or" substance and direction. Therefore, this study proposes a harmonizing approach -- "both-together" -- in dealing with the environment and economic motivation of the firm. The proposal is based on the conviction that the quality of the environment as well as continued growth, productivity and profits are essential to the promotion of the quality of life.

The discussion of corporate social responsibility is carried over to the accounting profession because of its ultimate involvement in the conduct of the modern corporation. The credibility it adds to corporate financial reports as a result of the profession's attest function has the power to influence not only the behavior of users of these reports but also the ultimate allocation of the economy's resources. In this context, accounting has the power to forge and direct social change. In the past, the social contribution of the accounting profession has been viewed indirectly. For instance, whenever the accountant helps a business survive competition in the marketplace, he is doing a great service to society. Recently, this passive role of the profession has been replaced by a more active involvement in social issues such as recruiting and training of minorities, aid to small business, aid to the education of the minorities, and the like. Unfortunately, not every accountant believes in this direct involvement.
A definition of the accountant's social responsibility has been offered. The study adopts the operational definition provided by Linowes and presented a philosophical definition of the concept as encompassing those actions and actuations of the profession which are directly or indirectly intended to perpetuate itself. Perpetuation of the profession requires the satisfaction of both economic and social motives.

To reinforce the arguments for the direct involvement of the accounting profession, a social profile of the accountant and of the accounting profession is formulated. Stressed in this social profile is the fact that accounting is a social institution and therefore it has to serve society. Emphasized in the social profile of the accountant is its importance in promoting business justice, and consequently, social and economic justice.

The specific demands of society from the accounting profession and the responsibility it has to perform to meet its direct and indirect social role, necessitate a thorough review and evaluation of the theoretical and practical foundations of the profession. It was argued in the study that while the importance of the profession has reached new levels, the relevance of accounting information has declined. Several reasons were advanced and discussed to support this assertion. The significant conclusion that can be deduced from these reasons is that there appears to be a teleological contradiction between the intended goal to be pursued and the goals actually pursued by the profession.
The study advanced the proposition that the ability of the accounting profession to adopt to its changing environment depends upon the framework from which its objectives and basic assumptions are derived. This proposition is used as the fundamental basis for the proposed framework upon which a contemporary accounting theory may be formulated. It starts by recognizing that the accounting profession is a social institution, and therefore, its primary role is to serve society. This basic social role shall be the basis for the formulation of a global service philosophy for the profession. This will in turn be the basis for identifying the secondary objectives necessary to attain the primary objective. Subsequent formulations are needed to come up with accounting postulates, principles, standards, practices, and procedures and rules.

In addition, this proposed framework for a contemporary accounting theory requires the expansion of the entity theory to the enterprise theory articulated in this study, and allows the integration of social accounting into the accounting discipline.

Finally, a methodology which would be useful in proving the coherence, logic, and ultimately, the validity of the proposed accounting theory structure has been identified as a cross-section of six methodologies: (1) systems approach; (2) sociological; (3) ethical; (4) deductive method; (5) inductive method; and (6) pragmatic.

The inability of the accounting profession to respond to new demands for information has been demonstrated in the case of its inaction regarding reporting the costs of the social activities of
the enterprise despite the growing clamor for these data. One of
the significant problems underscored in the study is that the
accounting profession does not look at the reporting requirements
of these social programs as a problem for the traditional reporting
model of the accountant, rather, it considers it as a problem of
social audit. However, it is contended in this study that the
traditional financial statement models of the accountant are still
the best media to report on the social activities of the enter­
prise.

To account for and report on the costs of the social
activities of the enterprise, the study proposes input costs as
a costing methodology for translating into dollar terms the
resources committed by a company to its social activities. Conse­
quently, a system of classifying these costs is offered for
future reference.

A detailed discussion was included concerning the account­
ing considerations of these costs of social programs. The study
concludes that the accounting problems involved are not as com­
plex as they appear to be. Existing generally accepted account­
ing principles are adequate to cope with the accounting consider­
ations of these social programs.

The reporting aspects of the social activities of the
enterprise have been considered. Specific disclosures have been
formulated for pollution control and environmental conservation
projects in the various accounting reports. A proposed revision
in regard to the earnings per share computation was also presented.
Similar disclosures were outlined for contingent liabilities, extraordinary items, discontinued business segments, and the cost of other social activities of the company.

The practical application of the costing methodology proposed in this study was verified in a feasibility study conducted with the cooperation of a large multinational oil company. Two other objectives of the feasibility study were accomplished: (1) the identification and classification of costs of social programs and (2) the accounting treatment of these costs. The actual presentation of such costs in the reporting models of the accountant was not undertaken due to certain constraints encountered in the feasibility study.

The feasibility study concludes that the costing methodology is workable. The major drawbacks that may be encountered, at least at the start, is the inadequacy, and more often, the inexistence of appropriate records. Likewise, the study confirms the conclusion reached in the preceding chapter that the accounting treatment of these costs is not as complex as it appears on the surface.

Finally, the feasibility study recommends that accountants should account for and report on the social activities of the enterprise in the manner outlined in the preceding chapter. Social audits, given the state of the art, may not be relied upon for this purpose within the foreseeable future.
Conclusion

Society's concern for the quality of life will continue, perhaps hand in hand with the production of material things. This concern has not been drastically changed even with the advent of the energy crisis. Therefore, corporate social responsibility will gain more attention than ever before. Evidence is becoming widespread for the institutionalization of the concept.

The social and economic rationale developed in this study to enhance the case for social responsibility leaves no doubt that business cannot ignore being responsive to social issues. The study concludes that the concept of corporate social responsibility is a vehicle provided by society for the modern corporation to justify itself as a social institution and for the managers to validate their so-called illegitimate powers.

That a larger quantity of goods can, in many ways, enhance the quality of life is undeniable. In fact, this is the basic argument in favor of growth. However, this argument is limited to the narrow and visible effects of quantity. It undoubtedly overlooks the less apparent effects. For instance, the convenience and the enjoyment derived from drinking beer in cans are apparent, but the less apparent considerations are the trash and the pollution problems resulting from the empty cans, not mentioning the unnecessary use of the economy's resources in manufacturing and disposing them. Therefore growth for its own sake will no longer be tenable; neither will the "no growth" proposition. Human life needs both the blessings of growth and the
amenities of "no growth." The study considers these two propositions as extremes, and proposes a compromise concept, the "both-together" proposition. This will harmonize the need for material things and the need for amenities that enhance the quality of life.

As the concern for the quality of life continues, the accounting profession, being a social institution, cannot continue the low profile it has portrayed for itself over the years. Its passive attitude has to be improved, if not changed, into a more active role demanded from it by society. The active role conceived in this study may take three simultaneous directions:

(1) drastic improvements in its traditional (passive) role; (2) direct involvement in social issues both as an individual or as groups, and (3) influencing corporate behavior towards responsible action. The latter needs a brief elucidation. In public accounting practice, for instance, because of the accountants great concern for maintaining their position as independent observer, discussions concerning a possible management decision are worded carefully so that the proceedings would not appear as though the accountant decided for management. Also, a possible avenue for influencing management action towards responsible behavior is the accountant-client contact. But the problem is that the accountant has no time to interact with his client except when the latter calls him concerning a specific problem.

The improvements that has to be done in the traditional role of the accountant is to review and evaluate the theoretical
and practical foundations of the profession in an effort to remove the teleological contradiction between the goals set and the actual goals pursued by the accountants as demonstrated in this study. This requires the formulation of a socially-oriented accounting service philosophy consistent with its social role. This study has provided a methodology and a framework upon which a contemporary accounting theory may be built. From a systems standpoint, this framework is an open system capable of recognizing and reacting to changes in its dynamic environment.

The major proposal of this study, contrary to the recommendation of the 1972 Committee on Environmental Effects of Organization Behavior of the American Accounting Association, is to account for and report on the social activities of the corporate enterprise in its traditional financial statement models. This proposal is based on the conclusions of the primary objective of this study that (1) corporate resources committed to social activities can be measured in monetary terms based on the input cost methodology proposed in this study; (2) the resulting costs of these social programs can be accounted for and reported on based on existing generally accepted accounting principles; (3) the cost allocation problem between the regular operation of the company and the pursuit of these social activities is not new for the accountants. However, experimentation is needed to come up with the most reasonable cost allocation methodology to insure the reliability of the accounting figures; and (4) the attest function of the accountant is not jeopardized or rendered
future research. In the area of accounting, the following are major areas for research:

(1) The shift from single to multi-goals of the corporate enterprise is just beginning. Consequently, the role of the accounting profession in defining or identifying these goals has to be explored and defined.

(2) The proposed framework for the development of a contemporary accounting theory still requires enormous investigation. The ground has just been scratched, so to speak.

(3) Corollary to the major proposal of this study, the AICPA has to come up with a definitive opinion on this matter. To do this, research projects with broad coverage similar to the feasibility study undertaken in this inquiry has to be undertaken to substantiate the findings of the feasibility study.

(4) The proposal for an industrywide disclosure procedures in reporting corporate social activities has certain merits; the most important of which is a meaningful comparison of the social responsiveness of each company within an industry. This proposal needs a thorough investigation, and the American Institute of Certified Public Accountants and the American Accounting Association can provide leadership in this respect.

(5) Research is needed to prove deeper into the nature and scope of social accounting and social auditing.

(6) What are the implications of these concepts -- social accounting and social auditing -- to current and future
unnecessarily difficult. Admittedly, the accountant has to increase his reliance on the opinion of experts from other fields. However, this is not new in the accounting profession. For instance, in the case of pension plans, the accountant has to rely on the opinion of the actuary. Or the most common case is the reliance of the accountant on the opinion of legal counsel as to the existence or status of contingent liabilities.

For internal reporting, the study concludes that both quantitative and qualitative data may be provided for internal users. It was, however, pointed out in the feasibility study that even for the subject company, whose record in social responsiveness is widely acclaimed, the immediate concern is to know how much in dollar terms, and from an input cost standpoint, social responsiveness is costing the company.

Finally, the study concludes that given the state of the art, the concept of social auditing may not be operational within a foreseeable future. However, if such a concept could be modestly undertaken, the social audit reports might be taken as a special report necessary to supplement the traditional financial statement models of the accountant. The study believes that the primary media for reporting these corporate social activities are still the traditional reporting models of the accounting profession.

Suggestions for Research

This study has been considered as a groundwork for more
accounting education?

Outside of accounting, the most significant areas for research as a result of this study are in (1) the institutionalization of the concept of corporate social responsibility and its integration into the strategic planning of the enterprise and (2) the operational application of the criteria for setting up social program priorities developed in this study.
APPENDIX A

ILLUSTRATIVE FOOTNOTE TO ENVIRONMENTAL CONSERVATION FACILITIES
Note — Property, Plant and Equipment - Pollution Abatement and Environmental Conservation Facilities

The Company's production, refining and other major operations contribute about (relative contribution in %) to the industry's air pollution emission of (amount in tons) annually consisting of (name of pollutants), and (amount of tons) of the water pollutants discharged by the industry into the nation's waterways composed of (name of pollutants). The industry accounts for about (percent of total pollution) and (percent to total pollution) of the nation's air and water pollution, respectively.

For the last (number of years), the Company has been implementing its pollution abatement and environmental conservation policy to comply with (federal law) and various state laws in the area which it operates. The implementation of this policy requires an average annual capital investment of (amount), about (percent) of the Company's annual capital expenditures. The cost to maintain and operate these facilities amount to (amount) annually. The total investment on these facilities as of (accounting period) totaled (amount), (amount for previous year), with an applicable depreciation of (amount), (amount for previous year).

In order that the Company could meet the 1977 deadline for emission standard set by the Environmental Protection Agency, the following capital outlays and the projected reduction in pollutants are shown below:
<table>
<thead>
<tr>
<th>Capital outlay (millions)</th>
<th>% Reduction in Pollutants</th>
<th>% Emission Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974 $XX$</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>1975 $XX$</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>1976 $XX$</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>1977 $XX$</td>
<td>XX</td>
<td>XX</td>
</tr>
</tbody>
</table>

Note: Details of pollution by industry may be found in various studies undertaken by government agencies, particularly the Environmental Protection Agency, and various interest groups. For example, in the 1973 report of the Environmental Protection Agency, it was estimated that refinery emissions of hydrocarbons from catalytic crackers and regenerators were estimated at 158,000 tons in 1973, at 20 percent control. (See U.S. Government Printing Office, Annual Report of the Administrator of the Environmental Protection Agency, "The Cost of Clean Air," 1973.)
APPENDIX B

ILLUSTRATIVE FOOTNOTE TO COSTS OF
ENVIRONMENTAL CONSERVATION
AND OTHER SOCIAL ACTIVITIES
Note -- Costs of Environmental Conservation and Other Social Activities

The Company has an extensive environmental conservation programs (See Note [1]) and other social activities to attain its social goals, and the goals of society at large. During the year, the costs of these social programs are as follows:

<table>
<thead>
<tr>
<th>To Cost of Goods Sold</th>
<th>To General, Selling and Administrative Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>1974</td>
<td>1973</td>
</tr>
<tr>
<td>Depreciation of pollution abatement and environmental conservation facilities (Note [1])</td>
<td>xx</td>
</tr>
<tr>
<td>Cost to operate and maintain these facilities</td>
<td>xx</td>
</tr>
<tr>
<td>Research and development costs (Note [2])</td>
<td>xx</td>
</tr>
<tr>
<td>Charitable contributions</td>
<td>xx</td>
</tr>
<tr>
<td>Minority enterprise Assistance program</td>
<td>xx</td>
</tr>
<tr>
<td>Minority purchasing</td>
<td>xx</td>
</tr>
<tr>
<td>Affirmative action to hire minorities and women</td>
<td>$xx</td>
</tr>
<tr>
<td></td>
<td>$xx</td>
</tr>
<tr>
<td></td>
<td>$xx</td>
</tr>
</tbody>
</table>
The minority enterprise program is undertaken in conjunction with the minority enterprise small business investment company (MESBIC) program launched in 1969 by the Department of Commerce. The total minority enterprises helped during the year were (number), (number last year), with an aggregate loans of (amount), (amount last year). The number of minority enterprises planned to be helped next year will be increased by (number or percent), with an aggregate increase in loan grants of (amount).

The company plans to increase its purchases from minority suppliers from (amount) this year (amount last year), to (amount) next year. This would increase the number of minority suppliers from (number this year) to (number next year).

(Percent) of the company's working force consist of women and minorities. This will be increased from (number or percent this year) to (number of percent next year).

Notes: [1] reference to the footnote in Appendix A

[2] reference to the footnote on the company's policy regarding the accounting for research and development costs.
APPENDIX C

ILLUSTRATIVE COMPUTATION OF

EARNINGS PER SHARE
(Bottom of Income Statement)

<table>
<thead>
<tr>
<th></th>
<th>December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1974</td>
</tr>
<tr>
<td>Income before costs of environmental conservation and other social activities</td>
<td>$2,000</td>
</tr>
<tr>
<td>Cost of environmental conservation and other social activities, less applicable income taxes</td>
<td>$300</td>
</tr>
<tr>
<td>Net income</td>
<td>$1,700</td>
</tr>
</tbody>
</table>

Per share of common stock (assuming 1,000 shares outstanding):

<table>
<thead>
<tr>
<th></th>
<th>1974</th>
<th>1973</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income before costs of environmental conservation and other social activities</td>
<td>$2.00</td>
<td>$1.00</td>
</tr>
<tr>
<td>Cost of environmental conservation and other social activities, less applicable income taxes</td>
<td>$0.30</td>
<td>$0.10</td>
</tr>
<tr>
<td>Net income</td>
<td>$1.70</td>
<td>$0.90</td>
</tr>
</tbody>
</table>
APPENDIX D

A FRAMEWORK FOR ANALYZING THE RESOURCES

COMMITTED TO WATER POLLUTION CONTROL
I. Program identification and definition of cost or resource committed

a. A detailed description of the water pollution control program, stating its objectives, the equipment in use, capacity, serviceable life, etc. The statement of objectives shall specify whether or not the pollution control system is intended to (1) clean past pollution; (2) prevent present pollution; and/or (3) prevent future pollution.

Note: The company may have a program of restoring past pollution damage to the surroundings. If so, the activity should be analyzed separately in accordance with the framework of analysis proposed earlier.

b. Nature of resource committed:

(a) Capital investment in pollution control facilities

(b) Administrative costs, basically the salary and benefits of personnel connected with the facilities

(c) Repairs and maintenance

(d) Operating costs

(e) Other costs, including insurance premium, property taxes, and research costs.

II. Attaching monetary value to resources committed to the installation and operation of the water pollution control system.

(a) Depreciation of the water pollution control equipment based on the firm's depreciation policies. If the water pollution control equipment is a feature or an integral part of the plant machineries, the depreciation shall be the excess over the normal depreciation charge which would be applicable if the plant machinery did not have the pollution control feature.

Note: In the case of the oil industry, the American Petroleum Institute has published guidelines for determining the portion of the facilities which are intended for pollution control.
(b) The salary and related benefits of the personnel hired or retained to operate the system shall be part of the total cost of operating such system.

(c) If the existing personnel is utilized to look after the installation, the salary expense and benefits to be charged to this operation shall be the amount of time spent multiplied by the average hourly compensation rate of such personnel.

(d) Repairs and maintenance cost of the system shall be identified to form part of the cost of operating the system.

(e) Cost of fuel used in the system. If the water pollution control equipment is an integral part of the plant machineries, fuel cost shall be the excess of the normal (average) fuel expenses incurred in operating a system without the water pollution control equipment. In the oil industry, the fuel cost can be ascertained using the American Petroleum Institute guideline.

(f) Premium paid for the insurance policy purchased to cover the water pollution control system.

(g) The property taxes levied on such facilities.

(h) Research costs incurred in making studies relative to the project.

Note: For accounting purposes, it is preferable to classify these costs into (1) cost to prevent present pollution, and (2) cost to prevent future pollution.

III. Evaluation of effectiveness

(a) The project shall be evaluated based on the reduction of water pollutants dumped into the water as compared with the goals set by the company or by regulation in this respect.

(b) The actual cost of the project shall be compared with the budgeted amount for the purpose.

(c) Periodic reports shall be required to ascertain the efficient and effective operation of the system.
IV. Planning and budgeting

Plan and budget costs based on:

(a) the evaluation in III above.

(b) the current and/or future plans concerning the project in relation to the goals and objectives of the company.
APPENDIX E

A FRAMEWORK FOR ANALYZING THE RESOURCES

COMMITTED TO MINORITY ENTERPRISE PROGRAM
I. Program identification and definition of costs or resource committed

a. Inventory of minority-managed businesses being helped, including a statement as to the nature of the assistance extended.

b. Nature of resources committed
   (a) Direct costs and expenses incurred in helping minority businesses.
   (b) Personnel time spent in helping minority businesses.
   (c) Share of the overhead of the department upon which the program is being undertaken.
   (d) Losses due to default or bankruptcy of the minority business if monetary assistance has been extended.

II. Attaching monetary value to resources committed to helping monetary-managed enterprises

(a) Specific identification of direct costs and expenses incurred in the project.

(b) The dollar value of personnel time spent in helping minority businesses (time spent multiplied by the average hourly compensation rate of such personnel).

(c) The department overhead shall be apportioned to the different activities within the department on some equitable and reasonable basis.

(d) Actual loss, that is, the amount of the loan or investment less any amount recovered.

Note: If monetary assistance has been extended either in the form of loans or investment, the income derived from such loans or investment shall be deducted from the above costs.

III. Evaluation of effectiveness

The project shall be evaluated in terms of:
(a) the goals and objectives set to be accomplished (such as the minority business helped, its contribution to the economic condition in the community, etc.), as well as a comparison between the amount budgeted for the project with the actual cost incurred.

(b) the success of the minority businesses helped or being helped.

(c) progress reports to be rendered by the officer helping the minority businesses.

IV. Planning and budgeting

Plan and budget costs based on:

(a) the evaluation in III above.

(b) current and/or future plans for the project, in relation to the goals and objectives of the company.
APPENDIX F

ILLUSTRATIVE SUMMARY REPORT OF

MINORITY ENTERPRISE PROGRAM
NAME OF SPONSOR COMPANY

Minority Enterprise Small Business Investment Company

A STATUS SUMMARY REPORT

Company Information Sheet

Name of company
Nature of business
Purpose
Ownership
Date organized
Capitalization
Average number of employees:
  Blacks
  Indians
  South Americans
  Others

Community Information Sheet

Location
Area in square miles
Population
Minority groups as % of the population
Type of community (urban, rural, etc.)
Economic base

(Sponsor Company) Involvement

Nature of participation
Major co-sponsor, if any
Extent of participation (include % of money contributed to total capitalization)

Financial Highlights

1973   1972

Total revenues
Net income after tax
Dividends paid
Dividend paid per share
<table>
<thead>
<tr>
<th></th>
<th>1973</th>
<th>1972</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total payroll</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total taxes paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Federal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>State (includes sales and property taxes)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**General Comments**
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Other Materials


VITA

Manuel Atendido Tipgos, the son of Teodulo Tipgos and Encarnacion Atendido Tipgos, was born in Dimasalang, Masbate, Philippines, on August 19, 1939. He received his elementary and secondary education from the public schools in Dimasalang, graduating from Dimasalang High School as a valedictorian in March 1957.

He received his bachelors degree in business, major in accounting, cum laude, from Far Eastern University, Manila, Philippines, in April 1961. He passed the Certified Public Accountants Examination in the Philippines in 1962.

In the Spring of 1965, he entered the MBA program at Texas Tech University, Lubbock, Texas, and received his degree in January 1966. During this time, he worked as a graduate teaching assistant in the Department of Accounting.

Prior to entering the MBA program at Texas Tech, he worked in various capacities in business and industry. His last position was an internal auditor of a large bank in Manila.

After his graduation from Texas Tech, he joined Price Waterhouse & Co., New York as a staff accountant. In July 1967, he was moved to the firm's Manila affiliate where he became manager in the audit department in July 1970.
While in Manila, he accepted part-time teaching assignments both in the undergraduate and graduate levels at Far Eastern University. He likewise accepted special lecture assignments at the CPA Review School of Philippine College of Commerce. He was active in the Philippine Institute of Certified Public Accountants, and had served in various capacities in the standing and special committees of the Institute. He has published several articles in various professional and technical publications in the Philippines.

In the Fall of 1971, he entered the Ph.D. program with a major in accounting and a minor in marketing. During this time, he worked as a graduate teaching assistant in the Department of Accounting. In April 1973, he was awarded an Arthur Andersen & Co. Foundation dissertation fellowship. Likewise, in November 1973, he was selected by the National Affiliation of Concerned Business Students (NACBS) as one of the "scholars" of its Scholar Program for 1973-74 to work with a multinational oil company concerning the latter's social programs. The result of this project will be presented in the national symposium of the NACBS in October 1974.

On Christmas Eve of 1973, he married Maria Luisa Francisco of Manila, Philippines. He is currently a candidate for the degree of Doctor of Philosophy in the Department of Accounting.
EXAMINATION AND THESIS REPORT

Candidate: Manuel Atendido Tipgos

Major Field: Accounting

Title of Thesis: The Accounting Aspects of Corporate Social Responsibility

Approved:

[Signatures]

Major Professor and Chairman

Dean of the Graduate School

EXAMINING COMMITTEE:

[Signatures]

Date of Examination:

June 11, 1974
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