

“Events” Approach to Basic Accounting Theory: How Far Away Can It Go*

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Abstract: As a totally new accounting theory, “events” approach to basic accounting theory tends to reform traditional accounting theory. Its main idea is providing detailed information about economic events that allow individual users to generate their own input values for their own individual decision model. From existing literature, we can find that this theory has not formed a perfect system, study on it is not deep and the theory itself has some drawbacks. The goal of this paper is to introduce this theory systematically. By analyzing the drawbacks of this theory, this paper proposes some solutions to improve it.

Key words: “events” approach; drawbacks; solutions

1. Introduction

“Events” approach to basic accounting theory was proposed first by George H-Sorter. The main idea of this new theory is that the purpose of accounting is to provide information about relevant economic events that might be useful in a variety of possible decision models. Accounting should provide information about relevant economic events that allow individual users to generate their own individual decision models, instead of producing unknowable decision models directly (Sorter, 1969). As a progressive theory, “events” approach has realistic advantages from both theoretic view and practical view. This theory, however, has some drawbacks itself which impeded its development. This paper analyzes some drawbacks of “events” approach first, and then proposes some solutions to them.

2. Some Drawbacks of “Events” Approach to Basic Accounting Theory

After Sorter proposed “events” approach first in 1969, other western scholars developed his theory, especially they proposed several kinds of accounting information systems based on “events” approach. Generally speaking, “events” approach got much attention in western accounting society from 1970s to the early 1980s. Since middle of 1980s, however, papers about “events” approach almost disappeared from western main accounting magazines and this theory didn’t move forward again. To find the reasons about this situation, our view is that we must study drawbacks of “events” approach first but not denying it completely. With the rapid development of society, environment of accounting has changed deeply, and new environment leads new viability to “events” approach. Now what we must do first is to find out drawbacks of this theory, and only in this way can we push it forward. We think its main drawbacks are as follows:

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2.1 Reporting All Detailed Economic Events May Reveal Firms’ Business Secrets

As mentioned above, the main idea of “events” approach is providing disaggregated economic events and users will restructure them by themselves. From theoretic view, this model can help users to make specific decisions, but it’s impossible in practice because it will reveal firms’ business secrets.

With the development of society, the markets that almost all industries are facing tend to be saturation. The competition among firms nowadays is actually competition of their core competence. Core competence is those unique capabilities that help a firm to keep extended competition advantages and those capabilities come from full use of resources and effective combination (Ruzhong Cao & Guihong Wu, 2005). The core competence of a firm includes not only those special assets it owns, such as trademark, specific technology etc., but also capability of combining resources effectively at management level. This core competence is the most major factor that ensures the firm to survive and develop in serious competition. One of the most major reasons why Coca-Cola Company makes so great achievement is just that it possesses a unique way of mixing materials which is its core secret. This secret will be known by its competitors if the company reports detailed information about this. If so, the advantage of the company will lose. From the view of compelling report, the government will protect firms’ business secrets instead of compelling them to report. For example, China published *the Law of Illegal Competition* in 1993 to protect firms’ business secrets.

2.2 Reporting Detailed Events Information May Cause Information Overloading and Information Confusion

Information overloading means that because the brain of human has a terminal in processing information, if the quantity of information during a period exceeds this terminal, it will lead to invalid results. And information confusion means that brain can’t identify information that is needed if information is excessive.

Traditional accounting provides information through several general statements. This kind of financial statements is convenient to be absorbed by users because it is standard models and they are tabloid. But in the model of “events” approach, what are provided are disaggregated economic events which will be more than those general statements in traditional accounting model. Especially when the number and the scale of firms are growing speedily, users will face more and more complicated information. To make specific decision, users have to compare and reduce those information from different firms, and large number of events information may cause them puzzled and this will lead to information overloading and information confusion.

From the view of users, they may not need very detailed accounting information. Zhengfei Lu et al. (2002) ever made a survey and they found that users preferred more forecasting information, but they didn’t think it’s better to report more information.

2.3 No Prerequisite Norms to Make “Events” Approach Applied

An accounting theory needs corresponding norms to make it applied in practice, and a good example is accounting standards. We can see the importance of accounting norms from the process of American accounting standards. Before 1930s, there were no uniform accounting norms around all America and its accounting was free. Firms had no responsibilities to provide financial reports, and only some listed companies did so to get more money, but what they reported lacked comparability because different reports from different firms had different forms and contents (Minghai Wei & Kaisong Gong, 2001). This caused accounting very confused and also limited the development of accounting theory. What’s more, it was one of the major reasons that led to the economic crisis from 1929 to 1933. After this crisis, America established CAP (1959-1973) to research and publish accounting standards. Later, this organization was replaced by APB (1959-1973), then by FASB (1973 till now). The replacement of organizations concerned with accounting standards elevated the level of standards and promoted the development of accounting theory.

Analyzing from current literature, we can't find any paper that discusses how to establish accounting norms about “events” approach and this limits the development of this new theory badly. To establish norms, we must consider some questions as follows. (1) The standard of economic events to be identified. The economic events generating in a firm are too complicated to decide what will be chosen into accounting system. It's materiality principle that is used by traditional accounting to solve this question. But the hypothesis of “events” approach is that what users need are unknowable, so it's also difficult to decide what events have materiality which are useful to users in their decision-making. (2) The choice of measuring ways and measuring nature. “Events” approach emphasizes multi-dimensional measuring ways and measuring nature, but it's difficult to choose appropriate measuring ways and measuring nature. For example, how to report the information about human resource? Should we report it by employees' education backgrounds, their working experiences or the expenditure that employers pay on them? (3) Reporting ways of economic events. Economic events must be classified by their nature when they are being reported and it's difficult to decide appropriate standard. In addition, we must research the way of reporting with multi-dimensional measuring ways and measuring nature concerned with an economic event. (4) Forms and contents of financial reports. To different users, the same kind of economic events which they get from different firms can be restructured to same reports with same forms and contents, or these reports will lack comparability. So we must establish the standards of forms and contents of financial reports.

2.4 The Developing and Conserving Costs of Information System Based on “Events” Approach Are High

“Events” approach is based on advanced IT technology, but we will face very high developing and conserving costs if we try to develop information system applicable to “events” approach. Reasons are listed as follows. (1) In “events” approach model, what are reported are just disaggregated economic events. So the information system must involve a super data warehouse and be safe and steady. To do that, we need lots of money. (2) According to “events” approach, users can visit economic events saved in firms' data warehouse timely, and this may cause many users visit the data warehouse of the same firm at the same time. To ensure the safety of visits, the firm must develop net equipment and technologies with high frequency and this can also increase the developing costs. (3) Firms need advanced computers and must renew and conserve their data warehouse timely every day and this may also increase the costs of firms. For small firms, these costs are not easy to afford.

3. Ways to Amend and Improve “Events” Approach

As a progressive accounting theory whose aim is to improve traditional accounting theory, “events” approach has some advantages that traditional accounting lacks. But accounting is a reactive subject that can't outstep or lag the environment around it. “Events” approach absolutely has the tendency of outstepping current environment, which makes it difficult for this theory to be applied in practice therefore its development is impeded. So we think it's prerequisite to amend and improve it.

3.1 Selecting Economic Events to Decide What Degree of Detail to Report

Because reporting too detailed economic events may cause firms' business secrets disclosed and none will do so. It needs to distinguish those events and select those that won't let business secrets disclosed and report them in detail, such as revenue, intangible assets, human resource etc.. But other information like core technologies and main customer resource may be concerned with business secrets and they can be reported with aggregated forms. The government should make standards to rule what kind of information can be reported in detail or with aggregated forms.

What must be pointed out is that selecting economic events we mention above is different from the selective

disclosure in SEC’s *Regulation of Fair Disclosure*. What SEC means is that listed companies report different information to different users and this reporting model has violated the regulation of fair disclosure (Shilong Tao, 2002). But when we mention selecting economic events, we want to point out that it’s only concerned with information providers and all users will receive the same information.

3.2 Aggregating Events Information to Some Degree

Because reporting too detailed events information may cause information overloading and information confusion, which will lead “events” approach to go away from its aim: promoting the decision-making through accounting information, we can aggregate events information to some degree.

Johnson (1970) divided summation into three kinds: (1) Aggregation. It means that a summation is the simple addition of the same kind of measurement on numerous occasions of the same characteristic of the same kind of happening. (2) Combination. It means that a summation is the addition of numerous measurements of the same characteristic of different kinds of happenings. (3) Composition. This kind of summation is the addition of numerous measurements of different kinds of happenings. From the view of “events” approach, we think it’s appropriate to use the first type of summation when we sum economic events because it won’t destroy the characteristics and structures of events information aggregating. By this summation users can receive raw events information though they have been aggregated.

We can use layering reporting to report events information, that is to say we can save different degrees of aggregation events in the firm’s data warehouse. For example, the first layer is disaggregated raw economic events, the second layer is economic events that have been aggregated to some degree, the third layer is economic events that have been aggregated to higher degree etc.. Users can choose different layers of events information according to their wills. Of course, we can add connection among these layers to let users to convert among different layers of information.

3.3 Establishing Applicable Norms

Although “events” approach emphasizes to provide raw events information, it doesn’t mean it needn’t to establish norms. We must establish norms to guide accounting practice if we wish “events” approach to be applied in practice.

We think these norms should include contents as follows. (1) The standard of economic events to be identified. We have mentioned above, one of the hypotheses is that the need of users is unknown, so we must investigate what kind of information users need before establishing norms first and then choose information among events through materiality principle. (2) The measurement ways and measurement nature concerned with economic events. The norms should regulate what measurement ways can be used according to different kinds of economic events. For example, we can use education time and working years at the same time to measure human resource. To different economic events we can also regulate different measurement nature. For example, we can use historical cost and current value at the same time to measure inventory. To ensure the truth and fair of the reporting, the price of this kind of inventory and similar inventory should be disclosed at the same time. (3) The standard of forms and contents of financial reports. To ensure the comparability of accounting information, the forms and contents of financial reports that come from events information saved in firms’ data warehouse must be standardized. Even though events information of a firm is complicated, different users can get same financial reports that are consistent in forms and contents through standardizing. (4) The standard of software. We should make consolidated standard for the software that is used to generate and report events information. In vocabulary table, data warehouse and the form of financial report, different software should use the same standard and different software should convert data with each other and by this way the input and output of accounting information among different software won’t be affected.

3.4 Establishing Public Reporting Channel Used to Report Events Information

Events information is saved in the data warehouse of every firm and this will prevent users from visiting the data warehouse of different firms conveniently. So the government should establish a specific website used to report events information. This website concentrates basic information of all concerned firms and it connected with the data warehouse of every firm. Users can visit the data warehouse of a firm directly through opening the connection after finding the basic information of a firm.

In China, the websites of China Securities Regulatory Commission, Shenzhen Stock Exchange and Shanghai Stock Exchange start to disclose financial report of listed companies, but this is not the main errand of these web stations, and this will not only limit the quantity of firms that want to disclose reports, but also will affect the quantity of information that can be disclosed. So , big websites needed to disclose special accounting information.

4. Conclusion and Research in the Future

As a new accounting theory whose aim is to improve traditional accounting theory, “events” approach came from profound historical backgrounds, and its existence is reasonable to some degree. Traditional accounting is lacking accommodation with the development of society, and just because of this, people are criticizing it heavily and many new revolutionary accounting theories and approaches appear, for example, there are “events” approach, value chain accounting and net accounting etc. Though these theories and approaches are not perfect and they didn’t become the main accounting theories and approaches, after all they set good tries and they are a good start. No matter whether these new theories and approaches will succeed or not at last, it will give us some inspirations and push accounting forward definitely.

Up till now, “events” has not formed a perfect theory system, we think the major reason is those drawbacks of this theory. So we must do more research and push it forward. We think there are some questions that deserve us to research in the future as follows. (1) Research on the condition that can support “events” approach to be applied in practice and the main difficulties that it faces. (2) Research on how to establish accounting norms for “events” approach. And it should include the classification of economic events, recognizing, the standard of reporting, the standard recording of economic events and exchange and the standard of software etc.. (3) Research on how to modify “events” approach and correct its drawbacks to make it more convenient for operating. (4) Use positive accounting to research whether “events” approach is actable and its possible problem.

We believe that with the development of society the advantages of “events” approach will be approved by people and more and more scholars will focus on the research about “events” approach and this theory will improve greatly in the new century.

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