

John Dewey's Cultural Business Guidelines: Scientific Foundations of Financial Disclosure

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*The US philosopher John Dewey identified elements of his cultural guidelines for business in *Human Nature and Conduct* (1922) and *Experience and Education* (1939). These fundamentals have acknowledged the democratic structure of business accountability (Westbrook, 1991). This opened the door to ingenuity and progress in the face of opportunities presented to management. During the past fifty years micro-economists have argued with practicing accountants about the need for uniformity and uses of current market values in balance sheets. This article argues against this economic authoritarianism, seeking instead to follow the evolution of accounting reporting practice over 350 years. This has much in common with the nature of democratically induced business accountability in the modern era.*

1. Introduction

This article examines historical and philosophical elements of the evolution of accounting practice over three centuries together with the theoretical basis of business culture given by John Dewey (1922, 1939) for understanding educational and behavioral aspects of business conduct. This is needed because of the prediction that conflicts between economic value and moral values cannot be resolved away from the conjunction of public and individual interests proclaiming the nature of the “common good” under some relevant technology. The technology of practice and the theories of knowing and learning come together under Dewey’s philosophy of pragmatism. This can explain why, in the 300 years since accountants abandoned generalisations leading to either uniform market valuations of the firm or estimations of wealth for the whole entity, practitioners used suitability as allocation of historical cost. Market based economic income theory is not sufficiently robust to carry the external reporting function of society, the two aims of which have been (1) conflict resolution or objectivity and (2) distributional morality under community regulation.

The importance of A.C. Littleton’s contemporary introduction of John Dewey’s pragmatism as the foundation of financial disclosure in the 1950s has been allowed to drift under a sustained attack from micro-economists at that time and since. There have been two major reasons behind economic criticism:

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1. Littleton's emphasis on historical cost to guard against unjustifiable valuations of assets which cannot "add up" incrementally to a value of the whole entity in balance sheets (Larson & Schatke, 1966);
2. A failure to recognise that historical cost could be used in conjunction with current cost and management value but only in Littleton's profit or income statement context, not for balance sheets. Current market valuation is not operational for conflict resolution, or economic decision-making, the respective reporting objectives of accrual accounting and economics. (Beaver & Demski, 1979)

This concept of additional benefits, profit or gain provides the linkage to John Dewey (1922). Littleton knew that it had been fundamental to accounting and financial reporting for hundreds of years (1953:Ch2; Jones & Aiken, 1994). Profit is a moral concept which can be qualitative only in a particular learning situation (Dewey, 1933:Ch6). It has grown in power and structure under the heavy influence of the moral philosopher David Hume (1739) who raised difficulties for scientific outcomes leading to positions and results remote from social benchmarks. These are intended to guide human conduct in a community setting (Dewey, 1922). The matter will be elaborated here by reference to two fundamental issues, which can underlie the relevance and integrity of financial reporting as a social control over management strategy and performance.

1. Dewey's principles, rules and postulates which were used to explain the cultural origins, principles, rules, conventions and ethics under induction of the nature of the evolution of business culture as a phenomenon in America especially during the first half of the 20th Century (Westbrook, 1991); and,
2. The historical context of the origin, persistence and growth as the evolutionary process given theories of social and accounting activities following the advancement of science since about 1650. Historical cost has not been a traditional uniformity of practice but has been a variable periodic invested cost governed democratically by accountability.

These matters will be examined in the following sections. This is where micro economists failed to stress investigation, preferring instead to concentrate on a revolutionary balance sheet valuation approach, which suited their policy and valuation concepts of measurement. In particular they equated historical cost usage in accounting practice with a notion of a purchasing price frozen in time from their own balance sheet valuation concepts of wealth and changes therein. Ijiri (1971) pointed out like Littleton (1953) before him, that accounting practice had been about the allocation of historical costs for periodic determination of invested cost under accountability, an ongoing expression of social responsibility among managers and participants. These allocation views of accountability still dominate practice (Aiken & Ardern, 2003). In Littleton's words, the total of costs invested towards the firms' overall aim in practice is not defined by means and ends as in theory. Invested cost less revenue represents Dewey's "true" or

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“common good”; revenue is the community’s compensation (1953:p95) and profit is the reward for a job well done in a qualitative or particular environmental sense. Edwards and Bell (1961:Ch1) changed this to costs as economic inputs and revenues as economic outputs – that is, “what is owned and what is owed” as a balance sheet feature of value to the owner. What a massive aspiration! No wonder such a cathartic revolution has not worked in practice (Gowland & Aiken, 2009). Except perhaps in perfect markets, prices generated by others and existing as current market prices, do not “add up” to the whole value of the firm as an entity in its environment as Dewey points out: “The (different) uses to which gains will be put are inevitably present” (1922:p221).

2. Historic Foundations of Financial Disclosure

As mentioned, this paper will examine briefly historic foundations of financial disclosure and elements of Dewey’s cultural hypotheses and theories for the development of business, especially in America after about 1890. While these qualitative concepts may have been overcome to some extent by market based assumptions after 1950, it does appear that the transition has been more comprehensive in economic theory and finance than in professional accounting and reporting practice. This need not be surprising given relevant aspects of financial accounting history. After a relatively short period of growth through partnerships, ventures and co operative and government business organisations, much of the business world became expansionist under the advancement of science after about 1650. Unjustifiable estimates of value for the whole entity were becoming socially and individually unacceptable and King Louis XIV of France introduced the Ordinance of 1673. While detailed accounting information was collected in journals and other books including details of property, the process had an inventory and production emphasis and was targeted towards legitimacy (Howard, 1932). The accounts were awarded superior status to other forms of evidence in matters before the courts and non-compliance by business traders, merchants and bankers could lead to execution. Morality of distributions (Hume, 1739) and social control of fast expanding businesses became paramount (Littleton, 1953:Ch5).

In this context morality as recognition of rights and obligations in society became supreme. Recognition of rights and obligations in a social setting acknowledged that a bargaining process had occurred between all stakeholders in the whole entity “ex ante” and that such bargaining had to prove a starting point for calculation of rights and obligations “ex post”. This fundamental pivot has carried through as an ideal of modern practice. It also laid the groundwork for the interpretation of data in the Ordinance of 1673 where accounting data were pre-eminent. Rights and obligations bargained among all stakeholders of the whole entity provided the only passage to the financial aim of the entity at that time. Definitions for deductive explanation of the modeling process were unknown. Then, the model became famous for the logical consistency of its internal apparatus as a foundation of private/public wealth accumulation and

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management. While Howard (1932) referred to the raising of bookkeeping processes above economic valuation at that time (1650), this was in order to preserve a measurement system for gain in the face of forces which could have destroyed co-operative effort given growing business complexity and size under the advancement of science. This was the Cambrian Revolution in accounting from self-interest to social control (Littleton, 1953:Ch5; Gould, 1982). Furthermore, this separation of economic value from social control became inherent annually in financial accounting and reporting in France (1807) and in England (1854) as has been examined by Jones and Aiken (1994). The Profit and Loss Statement was supreme in Britain in the nineteenth century. Also, at law the decision by Lindley. J. (1889) to refuse to generalise the use of depreciation; and the failure of the suggestion at law by Fletcher Moulin J. (1911) that profit and loss should be the difference between economic valuation in balance sheets at two points in time; showed value to be an inferior foundation for precedent than accounting processes in the context of longer term aspirations for the periodic identification of gain. This was in terms of the law's continuing responsibility for justice among interested citizens, not the promotion of an individual's economic gain, which can be solely a market-based concept. The "accountability" issue was not the periodic gain in markets of individuals, but the cooperative business concept as a longer-term social icon of control within the evolving culture of business activity (Littleton, 1953:Ch5) or the "true" good (1953:p17).

3. Nature of Dewey's Business Culture

The examination of human conduct through logical connectedness of observation and community standards of behaviour has a long history. The philosophy of natural humanism extends from Aristotle through to Hume and Dewey to more modern adherents such as Grene (1985) in evolutionary biology; Capra (1995, 2003) in ecology; and Hoy (2000) in philosophy. John Dewey applied the principles of moral authority to areas such as education in establishing a "learning situation" (1939) and to social psychology (1922) as the key to an understanding of business behaviour. Throughout he was concerned with the structure of human co-operation generally to meet business opportunities, particularly within a democratic framework for action. Rockefeller (1998:p146) states:

"In a post-modern world struggling to create democratic societies and a multi-cultural global community, Dewey's understanding of the democratic force continues to be of critical importance. Dewey's evolutionary naturalism, piety towards nature and faith in a scientific approach to the moral evaluation of human behaviors (*sic*) has gained a new relevance."

The difference between professional practices which analyse the accountability of management as the nature of the business being a first step for capturing integrity in financial disclosure and the mandatory selection of market prices for

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common decision making needs under economics bookkeeping (normative accounting) is now established. Management strategy for effort (cost induction) is towards capturing its own enlightenment or “common good”. This “good” is never twice the same in quality of presentation (Dewey, 1922:p218). The issue is specifically stated for the difference between professional practices and economics in a social setting. Objectivity in a mechanical sense of arms length or reproduction for justification of measurement, clarity or standardisation is different for professions. Dewey states:

“...objectivity is saved but at the social expense of connection with human affairs. Our problem (in professions) is to see what objectivity signifies on a naturalistic basis; how morals are objective, and scientific and secular.” (1922:52)

This is the problem that normative economists attempted to avoid in reporting for economic decision making (Chambers, 1966:pp259-300). However later work by Grene (1985) on scientific practices emphasised that the relevant subject matter in professions is usually multi-disciplinary (Aiken & Gowland, 2010). Relevance comes from the interacting components of interfield theories which impinge on the subject of attention, that is, periodic invested cost; comprehensive gross income or some forces of the practitioners’ attention. “Objectivity” as the force of a profession’s services is provided by friction between competing interfield theories (Dearden & Maull, 1977) in the modern era, as shown in Figure 1 and discussed in the next section.

The focus in the profession becomes some desirable quality of social behaviour under a democratic ethos which enables growth to occur in the environment. It is not simply a quantitative construct of observation and measurement of a subject at a moment in time. Thus Dewey states:

“To reduce all cases of judgment of actions to Evaluation of quantities is to miss the whole point of deliberation between economic and moral valuation of purpose.” (Dewey, 1922:p218)

Economics bookkeeping and its subsequent development into economic decision making by individuals misses the professional’s interpretation of the “nature of the business” as the scientific methods for capturing “interfield” components of action (Grene, 1985:p10) in a comprehensive identification of either income or cost as a social control over time. Also, growing intangibility of organisational functions is now a problem for periodic market valuation (Kaplan & Norton, 2004:Ch7). Given also that the economic tool of means/ends analysis provides a poor prediction of normative conduct in terms of a community’s qualitative behavioural standards (Dewey, 1922:p223), the relevance of market prices is always tenuous. Thus objectivity in terms of conflict resolution has become the focus of financial disclosure since about 1650. Also, multi-disciplinary analyses may be required to capture human behaviour. In financial reporting, disciplines

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which impinge on the interfield process can include biology, politics, economics, management science and ecology to explain the interfield “nature of the business”.

“...neighboring disciplines also impinge on one another in interfield theories forming important identities.... In these cases no field is being reduced to the other let alone to some universal matter linked to science.” (Greene, 1985:p16)

This is the problem for accounting theory and practice to be reduced for economic decision making at the moment. Normative accounting in the 1960s was driven by the concept of reduction of scientific theories (Nagle, 1961:Ch11). However, a line of theorising which postulates that a secondary theory of accounting is to be reduced to within a primary theory of micro-economics need no longer be credible as a scientific ideal (Ayala, 1985). What exists now are (1) economic researchers wanting to serve shareholders and creditors with a decision useful reporting function based on micro-economic market prices and (2) accounting practitioners concerned with objectivity of financial statements for social control over the whole entity through conflict resolution and distributional morality. Ayala states:

“macro evolutionary processes are underlain by micro evolutionary phenomena and are compatible with micro evolutionary theories, but macro evolutionary studies {conflict resolution and distributional morality} require the formulation of autonomous hypotheses and models ...”. (Ayala, 1985:p77)

That is, micro-economic decision models will not support a macro- emphasis or social control over business affairs which has lasted for 350 years through relevant authoritative ordinances allowing a democratic approach to management’s actions in business affairs under legislative and legal constraints on behalf of the community generally.

“...in principle, there is not science as such; there are disciplines, naturally inter related and interacting, that develop as distinctive scientific practices.” (Greene, 1985:p17)

The context for the interaction of economics and accounting has changed as a science since the 1960s, especially as full reduction of accrual accounting for effective economic decision making. This has been non-operational for many years (Beaver & Demski, 1979). A practice of theoretical relevance from Dewey’s interdisciplinary social behavioural for social control as against an ends/means economic deductive solution using assumptions and market price has been partially exposed by accountants. Practitioners are now using historic or current cost or management value as a standard (macro). However Dewey’s social fixation is on gain as a social control not a value as an increment of an

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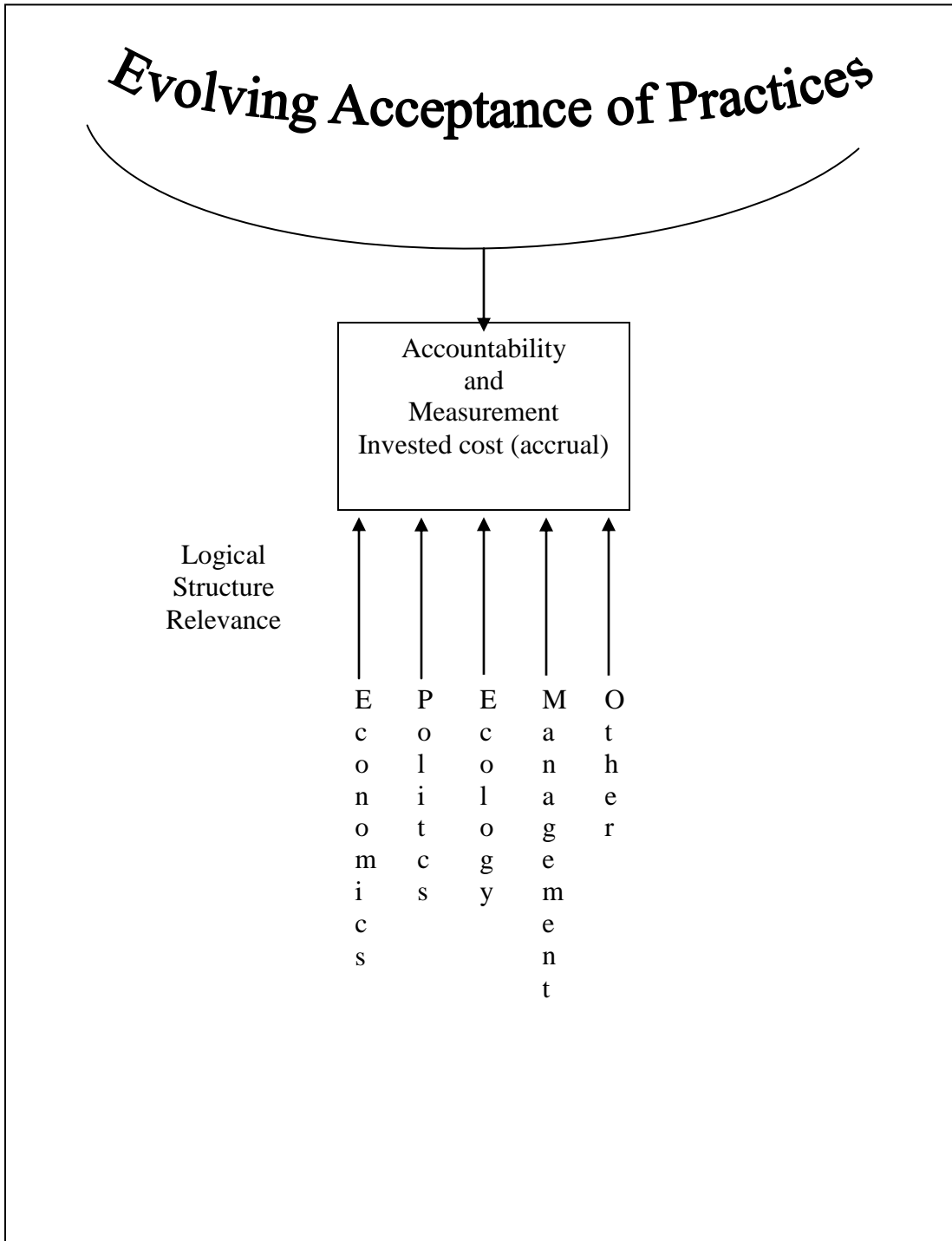
individual's wealth. This macro standard for the whole entity applies to gain, which is qualitative growth.

However, gain which for Littleton is revenue (compensation) less invested cost, being the "common good" cannot be understood under Dewey away from the specific plans and environmental conditions facing management. If periodic gain is a whole concept for conflict resolution under change and distributional morality among all parties of the whole entity within the society, then a professional ethos prevails (Dewey, 1922:pp40-62; 1939:Chs5&6). Littleton (1953) follows this pragmatic coupling of theory and practice:

"Furthermore integration of good theory and practice would thus be positive....in accordance with the facts and are such as to give due recognition to the relative interests of all parties concerned." (1953:p139)

Also, modern research studies can show that traditional emphasis on the profit and loss statement (Jones & Aiken, 1994) may now reflect complexities which were not apparent in Littleton's day. This is a reason for definite/precise research techniques for macro research applicable to conflict resolution and, particularly distributional morality of the whole as a social control in Dewey's multi disciplinary sense. It is not a "naturalistic" research exercise to remain with the economics/finance research paradigm of external disclosures. Figure 1 introduces the related issues of Dewey (1922), Grene (1985) and Littleton (1953) for objective identification of invested cost or the "common good" under the accountability paradigm (Ijiri, 1971). "In quality the good is never twice the same" (Dewey, 1922:p210).

Figure 1: Financial Accounting Theory as Developed Interfield Theories of Invested Cost



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The challenge is expressed by Aiken and Ardern (2003) which empirically maps professional consistency over time with choice of asset values where discretion is allowed by the standards. Also Bamber et al. (2010) point to preferences by preparers using “comprehensive income”, a more recent professional concept. Eighty percent of managers prefer to report the figure in the new incentive based Statement of Equity rather than in the Performance Statement of Income. Under traditional theories from economics/finance, the location of the indicator should not matter. However research reveals that this volatile figure in the Performance Statement makes the firm’s share price more vulnerable to change. Shareholders as a group are part of the consortium affected by financial statements. What is the impact of financial reporting as a social control for over 350 years upon the consortium of stakeholders as it exists in the modern era? Research has shown that traditionally choice is usually stable over time once a firm’s “optimum” reporting situation has been established structurally (Aiken & Ardern, 2003).

4. Objectivity and Interdisciplinary Control

In discussing interfield theories as introduced by Dearden and Maull (1977), Grene (1985) points to scientific practices which are mutually related and interacting (p17) as in the relevant theories of Figure 1 leading ultimately to objectivity through conflict resolution.

This interaction among a number of relevant disciplines may be used to explain the nature of multi-disciplinary concepts such as management “accountability” in complex community settings such as social behaviour and qualitative financial “gain” at period’s end. Whether or not this modern notion of conflict resolution can be attached to research which lifts balance sheets to providing “value” for the entity as a whole to a level of integrity which can sustain distributional morality outside the confines of the profit and loss account is unknown. However the volatility over time of asset values applied to privatisations of government businesses in Australia during the 1990s does not present a professional portrait of social control as the safeguarding of the rights and obligations of citizens generally given moral management criteria of public financial affairs by governments and their economic decision makers (Gowland & Aiken, 2009). Crunching current or historic prices of assets into balance sheets without management’s consent or with loose justification of standardisation at the micro level of the firm as a whole can jaundice the status of financial statements justifying transactions. However objectivity as the factor of friction among relevant disciplines in a community setting as in Figure 1, might place pressure on the policies of strong external parties wishing to use financial disclosure to enhance their own fortunes. The legitimacy of accounting data and reporting standards for over 300 years has been a function of the integrity of the accounting statements in their own right; not the acceptability under alien criteria and credentials of the results to be tabled in the context of the external policies and calculations for modeling and action, when displayed within the traditional iconic structure of financial accounting. The acceptable criteria are professional

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standards for conflict resolution and distributional morality as ancient professional principles, not assertions unrelated to logical interfield agreement.

5. Conclusion

Given the growth in size and complexity of business with the advancement of science after about 1650, ordinances approved in Europe emphasised the quality of accounting information. Quality related primarily to the excellence of accounting data for resolving conflicts in courts of law. The focus upon conflict resolution (objectivity) and distributional justification (community benchmarks) saw a movement away from individual decision making for wealth management towards identification of periodic financial accountability. Integrity in this context sought the conjunction in a particular case of biological science as the nature of the business; measurement standards adopted by accountants as a group for behavioral objectivity, not uniformity; and social compliance with benchmarks for linking behavior and morality (Hume, 1739). The experience of Littleton (1953) as an economist and accounting historian allowed him to relate the world of accounting practice under these Dewey essentials to constraints of disciplinary practice and scientific research (1922:pp320-35). This was for objectivity as professional awareness of behaviour (1922:pp50-2). That is in the words of Steven Gould (1982); a Cambrian revolution took place in accounting and financial reporting which caused great changes to occur in a very short time period on the evolutionary scale. Given this macro change to policy criteria for accounting, a scientific reduction of accounting theory for social control to micro economic theory underlying use of market prices uniformly would have been impossible (Ayala, 1985:p77, Beaver & Demski, 1979).

Dewey's ancient philosophy of naturalistic humanism under the golden rule for behaviour in business has provided science with an entry into objective analysis. The key has been observation of human conduct over the centuries (Hume, 1739). There is no reason to abandon such a platform for a process of deductionism and the assumptions of micro economics. Practitioners have recently moved towards this economics means/end relationship through "fair market value" but regulators are becoming restless. A contemporary vision of "variable historical cost" as the periodic pathway to the "common good" is required as in Figure 1 (Dewey, 1922:p210; Littleton, 1953:p17). From here, revenues as compensation are deducted. This ancient process of profit determination might still represent the optimum notion of "gain" in the modern era of social control (Dewey, 1922:pp221-3).

The economist Canning (1929:p319) was critical of the emphasis of accountants on productions rather than consumption as the hub of social benefits and on management valuations at period's end. If these two long-lived conventions are to be explained by a scientific theoretical structure (Littleton, 1953:Chs1&2) then this will need to be more comprehensive for social control as conflict resolution

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and distributional morality than the present theoretical structure of micro-economics.

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