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HALL OF FAME HISTORY CONFERENCE: A REPORT

by

Thomas J. Burns

The Ohio State University

The Academy held its annual research conference on "U.S. Accounting History: 1965-1990," an Accounting Hall of Fame symposium co-sponsored with The Ohio State University (where the Hall is located) on November 20-21, 1992. The conference consisted of three panel discussions; each one on U.S. accounting history from a different perspective: academic, industrial, and professional. The distinguished panelists who helped create much of this history included ten Accounting Hall of Fame members: Robert Anthony (Harvard University); Norton Bedford (University of Illinois); Sidney Davidson (University of Chicago); Philip DeFliese (Columbia University and Coopers & Lybrand); Yuji Ijiri (Carnegie-Mellon University); Charles T. Horngren (Stanford University); Robert K. Mautz (Universities of Illinois and Michigan); Herbert E. Miller (Michigan State University and University of Georgia); Maurice Moonitz (University of California); and David Solomons (London School of Economics and the Wharton School, University of Pennsylvania), the 1992 Hall inductee. Other panelists included the current CFO's of five large corporations: Eugene Flegm (General Motors); Gaylen Larson (Household International); Michael Sullivan (Sun Oil); Christopher Steffen (Honeywell); and John Quindlen (DuPont). Panelists from

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the profession included leaders of five of the "Big Six" firms: J. Michael Cook (Deloitte & Touche); Robert Elliott (KPMG Peat Marwick); Duane Kullberg (Arthur Andersen & Co.); Raymond Lauver (Price Waterhouse); and Philip DeFliese (Coopers and Lybrand). Ray Groves (Ernst & Young), scheduled to participate, was unable to attend. Moderators for the sessions were Robert K. Mautz, Steve Zeff (Rice University), and James Don Edwards (University of Georgia). Special guests at the conference included Dennis Beresford (Chairman, FASB).

Members of The Ohio State University Beta Alpha Psi chapter served as aides during the conference. The current Academy president (Thomas J. Burns, The Ohio State University) presided, and four former Academy presidents and many other Academy officers were present (including the secretary-elect Doris Cook, University of Arkansas and the treasurer-elect Michael van Breda, Southern Methodist University). Following the two-day meeting, many attended the big game (Michigan vs. Ohio State) which resulted in a tie, pleasing no one. The academy held its annual business meeting the following day. All conference sessions were videoed and recorded; the academy expects to publish the proceedings. J. Michael Cook, Chairman, Deloitte & Touche, announced the appointment of the Academy president as a Deloitte & Touche professor.

Session I–Accounting Educators

The academics, in their session, emphasized that there has been a growth of accounting research in universities by professors during this historical period and that new Ph.D.'s are increasingly better trained in interdisciplinary techniques (although most often accompanied by diminishing major interest in accounting problems and the frequent disappearance of accounting theory/concepts subject matter from Ph.D. seminars). Many argued that, typically, U.S. academic researchers often seemed to search for a problem to apply a research technique to instead of researching major accounting problems. The increased prestige of accounting research among other disciplines within the university (with improved promotion and tenure prospects for accounting professors) was accompanied by a sharp decline in the knowledge of and interest in accounting institutions by younger professors. One exception might be accounting regulation. Most acknowledged readily that to undertake a historical Ph.D. dissertation at their institution would not be seriously considered by most junior faculty and many senior faculty. Most accounting researchers are now identified by practicing one of three major research techniques: empirical, analytical, and perhaps behavioral. Other types of research receive a relatively minor appreciation, including perhaps the "critical thinkers" movement. Although field studies (most frequently called case studies) have had a recent revival, young researchers attempting

(l/r) Davidson, Zeff, Moonitz; (2) Horngren, Solomons, Bedford, Anthony.

such research would increase significantly their risk of not being promoted or tenured; since this research technique is not favored by university (or often even college) promotion and tenure committees.

Although there are now many more teaching prizes for professors than previously, and teachers are now more likely to bring their research into their classroom, particularly the younger and often more research-active faculty, teaching is now much more subordinated to researching than in earlier periods. However, as always, the best research investigations often come out of classroom discussions with students. However, new Ph.D.'s often learn a particular accounting subject the first time they teach such a course.

The panelists agreed that managerial accounting has shown the greatest improvement during this period, whereas financial accounting has not changed much. Little change (except in size) has occurred in financial accounting texts, whereas finance texts have changed drastically. Introductory texts were much more criticized by the panelists, most of whom have authored renowned texts. Complaints were made about the need to supply a suitcase of teaching materials nowadays to an instructor (instead of a text and a solutions manual) probably because over half of introductory courses are taught in community colleges by part time instructors who often have full time jobs elsewhere. Intermediate texts devote less space to models and concepts but more, much more space to FASB rules.

Those who teach in MBA programs report few MBA's go into public accounting firms, except maybe for consulting, although MBA's are now much older than previously (Stanford reports the average age of an entering MBA at 27). Undergraduates, particularly the brighter ones, are less likely to go into public accounting than previously. The academic input to the rule-making agencies was still slight, even by tenured professors. There is a major decline in articles on or debates of controversial accounting subjects. There was discussion of tenure (and possible legal vulnerability), professors serving as expert witnesses, and whether professors were continuing to be independent of their funding.

<u>Session II–Financial Executives</u>

The financial executives agreed that they are not only preparers of financial statements, but extensive users, as well. The greatest change in accounting during this period from their viewpoint was the enactment of FASB 106 on post retirement benefits. All agreed with the principle enacted and its social, economic, and political benefits, but they were not as satisfied with its complexity and cost. However, they believed that this change was the "high" of the period; the "low" expressed by several was FASB 96 on deferred taxes, which was, of course, eventually altered.

When asked why they had not implemented the principle of FASB 106 before the FASB, several replied they had done so internally but could not do so externally because of competition. If a single corporation had enacted this change lowering profits on public statements, their stock prices would have declined immediately in the stock market.

A consensus was reached that the chief value of standard-setters was to enact needed changes uniformly, which otherwise could not be accomplished. They reported satisfaction with the FASB rule-making process (given the change from 4-3 to 5-2 for standard approval) considering the alternative of government standard-setting. But they felt the extensive agenda (and numerous rules) of the FASB was much driven by the threat of liability and was increasingly concerned with compliance.

In discussing accounting for stock options, they argued that the current controversy over this subject is a policy issue, not really an accounting issue. The failure to communicate sufficiently what accounting does (and does not do) is a real problem. They also reported that their global corporations had major problems with harmonization.

The benefits received from participating in all stages of the standard-setting process were discussed. The executives stressed the advantages of actively participating in professional organizations such as the *FEI*. The informal networks with their counterparts at other corporations and the learning about accounting practices from each other were very important. The advance of internal auditing after the establishment of audit committees was reported to be a major change in industrial accounting in the last 25 years. Large

(l/r) Quindlen, Larson, Steffan, (2) Edwards, Sullivan, Flegm.

computers helped make internal auditing more thorough. Such auditing staffs were a mix of CPA-types and operating personnel. Many reported maintaining almost two sets of books, the first for managerial purposes and the second for external reporting purposes. Some differences reported between the two were: LIFO inventory, deferred taxes, capitalized interest, and R&D.

<u>Session III–Public Accountants</u>

The public accounting panelists, a mixture of current and historical figures, agreed that the greatest change in the profession over the past quarter of a century has been the growth in litigation which threatens the survival of even the largest firms. The U.S. has developed into a "no-fault" society. Unlike the rest of the world, U.S. citizens have the habit of going to court for grievances. By far, the most rapidly growing U.S. business is the practice of lawyers. As the chairman of the U.S. Senate Judiciary Committee (himself a lawyer) said recently, "the plaintiff's bar engages in legalized ripoffs." The legal principle which encourages this practice is the one of joint and general liability (rather than one of proportional liability). Auditing firms are often sued for being present (during the period when fraud was committed) rather than for the quality of their work. The financial implications of working in such a legal environment are neither insurable nor predictable. Without limited liability, a firm may encounter a "firmbusting" suit at any moment from which it won't survive. If firms are to survive such a death spiral, tort reform is necessary! In the U.S., torts are presently a 2.5% tax of the *GNP*; U.S. accounting firms currently pay over 10% of their annual fees for this purpose. There are at least two other major implications of this legal litigation environment. First, the profession, due to the threat of liability, cannot innovate new products (despite a possibly diminishing utility of their conventional auditing and financial statement products). Yet, some evidence exists that managers do not manage (as much as they reputably used to) and investors do not invest (as much as they supposedly once did) via conventional financial statements (because businesses, managing, and investing are infinitely more complex now). If so, or even if not so, the firms always need to be developing new products. Second, within their environment, firms find it increasingly difficult to recruit and to retain top talents. Without these talents, firms will have difficulty in maintaining the quality of their products; certainly the increasing cost of litigation can mean the firms cannot possibly afford the salaries of such talent.

Other major changes during this period for accounting firms were also identified. The change to a *global economy* (all businesses in the U.S. are global, although some don't know it yet) means firms must grow large to continue in this economy. If they don't do so, they must sharply cut back their service. The *gender diversity* changes now mean women are roughly 50% of firm hires and are now breaking through to be about the same percentage of new managers. Although women are only 4-6% of firm partners, that percentage can only continue to go up. Even though *competition* among the firms has increased extensively over this period (as the shortage of audit product disappeared) and firms are now much more consumer driven, such competition is small when compared to that of the soft drink, airline, or soap industries, for example. A major change has been the increasing *specialization* of the firms (although universities could not provide the specialization education to achieve the quality that comparable firms' training can). Most argued that although the business orientation of a firm has always been present, it seemed currently to be more prevalent. One panelist observed that firms used to be perceived as professionals operating in a business climate, whereas now it seemed more as if they were perceived as businesses operating in a professional climate. Another major change cited was much more *regulation* and government supervision. And of course, the major developments in *information technology* are other changes which have basically altered the way auditing and accounting are accomplished and how firms operate.

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(l/r) Miller, Defliese, Cook, Mautz, Kullberg, Lauver, Elliott.

COMMENTS FOR THE ACADEMY HALL OF FAME CONFERENCE: U.S. ACCOUNTING HISTORY (1965-1990)

by

Yuji Ijiri

Carnegie Mellon University

I regret very much that I was not able to participate in the discussion on Friday. When I received an invitation to this conference from the organizer, Professor Thomas Burns, I had already accepted an invitation to present a paper at a conference in Siena, Italy, a place near Pacioli's home town, commemorating the 500th anniversary of his landmark publication on double-entry bookkeeping. After my presentation and a lovely closing banquet on Thursday, which went beyond midnight, I left Siena for Columbus, a trip which took 24 hours door to door, including a two-and-a-half-hour pre-dawn drive from siena to Rome, during which the driver drove at 90 miles, 145 kilometers, an hour. I was frightened initially, but toward the end of the drive I found myself enjoying this high speed ride.

1. **The Increasing Professional Risk:** In the flight from Rome to Washington, I started thinking about the U.S. accounting development in 1965-90, the theme of this

conference, and began to wonder whether my experience in the high speed ride might not be comparable to the greater and greater risk the accountant has taken or been forced to take over the past 25 years. I am particularly concerned with the recent resurgence of market value under the notion of "Marking to the Market," because I cannot believe this is what the public wants. Their indifference to market value data in financial statements was the cause of the discontinuation of such a disclosure in the mid-1980s in the U.S. as well as in the U.K. Besides, the market value of the firm itself is already best indicated in daily stock quotations.

2. **Reflecting the Future Stock Price:** What the public–including investors, mass media, and jury members–expects is financial statements that reflect the stock price of the firm not on the statement date but, say, six months from the statement date! When their expectation is not fulfilled, they hold the accountant responsible, and, with a 20-20 hindsight, they easily find reasons to put a blame on the accountant. At the beginning of the 1965-90 period, there was a shift in emphasis from history-oriented information to future-oriented information under the banner of decision "relevance." Unfortunately, unlike personal computers that exploded during the same period on the basis of many breakthroughs in the IC chip and miniaturizating technologies, there were no technological nor educational breakthroughs in accounting that warranted such a drastic shift in the professional orientation. We handled market values and pension forecasts with no training as assessors nor as actuaries. We had to borrow from other professional expertise, while not fully utilizing our own expertise in handling historical information. Nevertheless, we enjoyed the feeling that we were providing more "relevant" information, discounting the significant professional risk we were taking in the meantime.

3. **Widening the Gap:** In the mid-1970s, I had an occasion to present a short paper at a public hearing of the Cohen Commission, which was charged to find a way of bridging the gap between what the public expects and what the accountant/auditor can deliver. Emphasizing the need to let the public know how the audit is done, I proposed to replace the blanket audit opinion with a concise description of what the auditor did and found, including the sample size. I believe that something of this kind is needed to bridge the gap, especially by telling the public exactly how small the sample size had to be in order to keep the audit cost in a feasible range. By staying with the blanket opinion, the gap has widened considerably during the past 25 years. Although the same wording is used, the meaning of "present fairly" dramatically changed as more and more subjective judgments on the distant future entered into financial statements.

4. **Records, not Reports:** More fundamentally, the 1965-90 period was also a period in which an utmost emphasis was

(l/r) Davidson, Solomons, Moonitz, Bedford; (2) Horngren, Mautz, Miller, Anthony, Defliese.

placed on financial statements, as if they were the only thing the accountant produced, neglecting the value of and the contributions made by accounting records (Foreign Corrupt Practices Act being a notable exception). We must realize and let the public know that accounting is built on comprehensive records of what happened in the past. The economy may suffer somewhat without financial statements, but should there be a blackout on accounting records, the whole economy will collapse in a matter of weeks, if not days, as no business can survive long without accurate accounting records. Lack of records will also let irresponsible behavior proliferate, quickly destroying the fabric of the economy. Mismanagement and fraud would not have been discovered in the first place without accounting records. We should let the public know that the fundamental contribution of accounting lies in records and not in reports.

5. **Speculation Fever, Again:** The first Chief Accountant of the Securities and Exchange Commission, Carman Blough, stated that "the speculation fever had become so great in 1929 that it is very questionable whether any amount of information about the corporation would have affected the way the general public would have bought and sold its stock, yet many turned to the inadequacy of the financial data as a scapegoat on which to blame their losses and to vent their angers and frustrations." ("Early Development of Accounting Standards and Principles," in W.W. Cooper and Y. Ijiri, eds., *Eric Louis Kohler: Accounting's Man of Principles*, Reston, 1979). The same thing seems to be happening in the recent litigation crisis arising out of the debacle of savings and loans institutions, only this time as a scapegoat for the industry-wide catastrophic losses.

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Legislation limiting auditors' liabilities seems to be the most important issue in the short run, but for the long run, we must do a better job of getting the nature of accounting and auditing understood by the public. I hope that at this conference held 25 years from now, we will be able to speak with a more positive and constructive tone about the future of accountants by building accounting on the solid base of historical records. ❑

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rating it, reference should be had, of course, to the market rate, or what might be obtained in exchange were the property offered for sale. In articles of merchandise–and particularly staple goods–this estimate is easily made, from quotations and general knowledge of sales; but in special property, such as real estate and things–on whatever basis made–must be, in a peculiar sense, arbitrary."

These accounts are also of interest because of the type of transactions included in their balances. For example, the Merchandise account is credited for the sale of merchandise as opposed to a revenue account. The Real Estate account is credited when rent is earned, and debited when property taxes are paid. If dividends would have been earned on the New York Central R.R. Stock, this account would have been credited in place of a revenue account.

The treatment of the Expense account that appears on the Business Statement is explained by Packard as follows: "..why not at once charge the amount in the Merchandise account, which represents this business? There would be no real objection to this, except that inasmuch as we have some other interests, a certain proportion of the expenses should be shared by these interests. What that proportion is, it may be difficult to say' hence, for convenience sake we open this separate account, leaving what seems to be an absolute loss here to be offset by an excessive gain in the other accounts."

The accounting treatment illustrated above is based on the philosophy developed by Packard in Chapter Three, entitled *Business*. He believed that wealth was primarily acquired through the activities of labor, rent, and exchange (gift and circumstance were also considered). Four of the activities are illustrated in the illustrative problem:

1. Labor: earning of commissions from purchasing and shipping goods to a customer.
2. Rent: earning of rent on real estate and interest on loans.
3. Exchange: sale of merchandise.
4. Circumstance: appreciation or depreciation of property in the firm's possession.

As a result of this philosophy, the impact of each activity is shown directly in the account affected.

If current GAAP were used to complete the illustrative problem (assuming all Office Supplies were used, and the entry of April 20th