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Comments for the Academy Hall of Fame Conference: U.S. Accounting History (1965-1990)

Yuji Ijiri

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