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Elias and Shaver: Paul Grady and his contributions to accounting and auditing
PAUL GRADY AND HIS CONTRIBUTIONS TO

ACCOUNTING AND AUDITING

by

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INTRODUCTION

The accounting profession has had many leaders throughout its history. These leaders have significantly influenced accounting thought due to their exceptional education, experience, and insight about controversial topics. Their influence extended after their death and continues to be the subject of discussion.

Paul Franklin Grady (1900-1984) was one of those leaders whose contributions to accounting will remain the subject of intensive study for future guidance. The purpose of this paper is to examine Paul Grady's significant contributions to accounting and auditing and to take the reader into Grady's mind as he was writing his most influential works. Grady strongly believed that in order for accounting to gain respect in society, it must be based on solid principles. His works showed this conviction.

After this introduction, Paul Grady's accounting development, including education, experience, and positions held are examined. This is followed by a study of his major ideas, contributions and their significance in the fields of accounting and auditing. The paper ends with a conclusion.

PAUL GRADY'S PROFESSIONAL DEVELOPMENT

Examining Grady's professional development, we find a strong background of academic and professional experience. Soon after graduating from the University of Illinois, he joined the staff of Arthur Andersen & Co., a major public accounting firm. After spending about twenty years with Arthur Andersen (1923-1942), he joined the staff of Price Waterhouse in 1943. His success in his new firm became evident when he became partner after only six months. In addition, he was named the firm's representative in the American

Institute of Accountants (AIA), the American Institute of Certified Public Accountants (AICPA) today. He served as chairman of a committee on auditing for four years and chaired the committee on relations with the SEC from 1954 to 1957. In 1963, he served as the Institute's director of research and a year later, he became a member of the Special Committee on Opinions of the Accounting Principles Board (APB). Grady's contributions were not restricted to standard-setting bodies but also to the Florida Board of Accountancy, on which he served from 1968 to 1972.

In addition to accounting related positions, he headed the Navy's cost-inspection service during WWII. He was also a part of the Hoover commission on the organization of the executive branch of the U.S. government.

Grady's background demonstrated a wide variety of posts in accounting, auditing and other fields. This variety undoubtedly contributed to his accounting thoughts and development.

GRADY'S CONTRIBUTIONS TO ACCOUNTING

Origin of "Inventory of GAAP":

Probably the most influential work of Paul Grady is Accounting Research Studies (ARS) No. 7: "Inventory of Generally Accepted Accounting Principles." This extensive study remains one of the most important accounting research studies in the U.S. Before detailing its content, it is interesting to study the events leading to its accomplishment as well as Grady's motivation for doing it.

An article in May 1962 entitled: "The Quest for Accounting Principles" centered around Grady's idea to develop the inventory. He noted:

The quest for GAAP is largely one of identification of the principles

on which there is general agreement and of developing a useful pattern of arrangement or classification.

Grady was motivated to undertake this study by the numerous criticisms against ARS Nos. 1 & 3, among which was that the standards were too radical and unacceptable for the time, in addition to not representing existing GAAP. Grady, therefore, noted that it was imperative to undertake a study of current GAAP before making any changes that would be rejected like those of ARS 1 & 3. He had this opportunity while working on the Special Committee on the Opinions of the APB, undertaking his landmark study that took two years to complete.

Contents of "Inventory of GAAP":

The study started with a definition of accounting and an acknowledgment that the greatest concern to an accountant was the fair representation of income. In the second chapter, Grady presented a discussion of the basic concepts underlying the financial statements. He stated that principles were rules derived by man to control business entities. He also stated that his work was based heavily on the work of Paton, Littleton and May. Grady identified ten concepts underlying the development of accounting principles. They were: society and government structure, business entity, going concern, monetary expression in the accounts, consistency between periods for the same entity, diversity in accounting among business entities, conservatism, dependability of data, materiality, and timeliness. Studying these concepts, we see the resemblance between them and current concepts. An interesting comparison involves consistency and diversity. Concerning consistency, Grady's definition still stands today and is an important part of the framework. As to diversity, Grady argued against rigid uniformity and for finite uniformity. He argued that companies should follow GAAP but that they should choose among alternatives that fit their specific industry characteristics. This argument is alive and well today and in fact, the FASB has sometimes allowed specific

industries to choose among alternatives. Because of his extensive experience in practicing accounting, Grady's study was geared toward the practicing accountant to serve as a reference. This feature was one of the strengths of the study and was lacking in many contemporary writings.

ARS No. 7 was published in 1965 and was welcomed by the profession. Since that time, over 300,000 copies have been sold, and it has been translated into Japanese and Spanish.

GRADY'S CONTRIBUTIONS TO AUDITING

Grady and the CAuP:

Paul Grady also made significant contributions to auditing. In 1943, he was appointed to the Committee on Auditing Procedures (CAuP), formed a few years earlier. Grady was appointed because of his thorough experience in auditing for over 20 years with major firms. Grady was also recognized as an expert in developing auditing procedures based on his experience with Arthur Andersen. During that time, he developed a manual entitled "Auditing Procedures: An Outline for Staff Training." This manual has been used by Arthur Andersen and Price Waterhouse in the U.S. and abroad. During Grady's term as chairman, the committee had the difficult task of defining auditing standards, internal control, and developing case studies in auditing. This task was accomplished three years later.

Generally Accepted Auditing Standards:

Grady characterized the committee's endeavors in developing GAAS as a "screening process to separate the 'shells' of standards from the 'sands' of procedures and to arrange the standards in a useful pattern." (King, 1989) In 1947, the committee published "A Tentative Statement of Auditing Standards: Their Generally Accepted Significance and Scope." It contained general field work and reporting standards and one year later, the standards were adopted by the Institute as GAAS. Grady has accomplished a very important task to be used in the future by all auditors.

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Pamphlet on Internal Control:

The concept of internal control is crucial in auditing. Grady believed that the concept was so important that it included all phases of business and should be regarded as a system of checks and balances. However, he noted that the then current study of internal control by auditors was "superficial, utilizing a standard questionnaire to try and cover all aspects of internal control every year." He suggested instead that auditors divide internal control into four or five logical segments and survey each one thoroughly every year. Under his guidance, the committee started working on an internal control project and in 1948 issued its report entitled "Internal Control-Elements of a Co-ordinated System and its Importance to Management and the Public Accountant." (King, 1989) The report included the importance of internal control in insuring management's competence and in reducing the possibility of fraud. The report also defined internal control widely to include budgets, standard costs, operating reports, statistical analysis, and an internal audit staff. It also stated that management was responsible for maintaining internal control measures. Due to this comprehensive study, auditors gained a better understanding of internal control.

Case Studies in Auditing:

Grady's contributions to auditing included developing case studies illustrating key audit concepts. The cases were developed and published in 1947 with the committee's standards. The case studies included diverse industries ranging from merchandising companies to public utilities. The procedures were taken from the workpapers of an auditor without disclosing his/her identity or the company's identity. Although Grady was not specifically identified as the creator of these case studies, his guidance and experience directed other members in developing them. (King, 1989) Consistent with Grady's focus on the practitioner, the cases were oriented toward practicing accountants.

CONCLUSION

Paul Grady (1900-1984) contributed extensively to the fields of accounting and auditing. His contributions in accounting included the landmark ARS No. 7: "Inventory of Generally Accepted Accounting Principles" in 1965. this study would be used, by practitioners, educators and students for many years in the future and would be used as a reference in developing standards.

In auditing, Grady developed GAAS, the principles that are still in use today. He also redefined internal control, an essential element in every audit. This study of internal control was so important that it sold over 200,000 copies. Under Grady's supervision, the Committee on Auditing Procedures CAuP) published case studies along with GAAS to help the practitioner apply theory to practice.

Paul Grady leaves behind a legacy of great contributions in accounting and auditing in an important period in the profession's development.

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