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Manuscripts must be in English and of acceptable style and organization for clarity of presentation. Submit three copies typewritten, double-spaced (except for indented quotations) on one side of 8½ x 11 inch (approx. 28.5 cm x 28.0 cm) white paper; paragraphs should be indented. An abstract of not more than 100 words should accompany the manuscript on a separate page. The manuscript should not exceed 7,000 words and margins should be wide enough to facilitate editing and duplication. All pages, including footnote and references pages, should be serially numbered.

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Editorial

It takes a long time for an editor to have a noticeable effect on the contents of a publication such as The Accounting Historians Journal. If his predecessors have done their job well—and they have—there are sufficient manuscripts in the pipeline to fill two or three issues that will appear under his name. Those responsible for book reviewing and surveying doctoral research are well advised to eschew sudden changes in form or content, absent compelling reasons that so far have not presented themselves. In short, readers of the Journal can expect the current editor to see that its standards are maintained, if not improved, but will not be able to satisfy themselves on this score for several issues to come.

It is useful, nevertheless, to review the editorial policy of the Journal, if for no other reason than to draw attention to the quality of its contents. In recent years, many accounting journals have increasingly devoted themselves to model building. The ready availability of computer programs, and the dominance that psychology has acquired over our intellectual life, influence accounting researchers to seek research problems in fields outside accounting itself. The application of quantitative or behavioral methodologies to accounting problems seems to feed upon itself, rather than upon the world of ideas and experience to which we are the heirs. The Accounting Historians Journal has demonstrated standards of accounting scholarship and intellectual integrity that must eventually convince more and more accounting students to start their pursuit of knowledge in its pages.

The Meaning of History

Historians establish the foundations for all human knowledge, because history, in the words of Leopold Ranke, is the written record of man. Some commentators have criticized this restriction to the written record, particularly those who advocate “oral history.” They argue that written history is the record of only one segment of mankind, the ruling class, and use tape recordings of elderly persons in order to throw light on the history of “the people.” Such a mistake would not be made by a historian, who knows how much we have learned about the lives of ordinary people thousands of years ago through the study of clay tablets and papyri.
The restriction is of great significance to the search for truth. Oral accounts of past events are subject to distortion, deliberate or accidental. Psychological experiments show how a message becomes garbled in transmission from one person to another, until it arrives at its ultimate recipient. A written record may also be biased or distorted, but that ceases the moment the record is made. From then on it represents the message that its maker sought to transmit, and we can use a variety of evidential materials to verify the truth or falseness of that message.

Arnold Toynbee, in *A Study of History*, identified three different methods of viewing and presenting the objects of thought: history, science and fiction. History is the ascertainment of facts; science, the elucidation, through a comparative study of facts, of general ‘laws.’ The artistic recreation of facts is the province of fiction. The need to keep this distinction clear is most acute where factual data are few. The method of science is appropriate where data are too numerous to tabulate, but not to survey. Fiction must be used where the facts are missing, or in the opposite case, too numerous even to provide us with laws. Where facts are few, historical method should prevail.

**The Need for Accounting History**

It is perhaps for this reason that Thomas Johnson, in the sixth Arthur Young Lecture delivered at the University of Glasgow on November 22, 1983, argued that accounting was unlikely to become a mature academic subject until it encompassed the study of accounting history. *The Accounting Historians Journal* is not the only source from which such knowledge can be derived, but it has become an indispensable tool since its beginnings a decade ago. Whatever the accounting problem—stock dividends, income taxation, consolidated financial statements, cost accounting, the development of accounting method from ancient times—it is becoming increasingly necessary to start with the index to the *Journal*.

There are many more contemporary accounting problems for accounting historians to investigate in these pages. The imputation of interest on invested capital; direct versus absorption costing; foreign currency translation; bank financial reporting; the list is long. The history of the methodologies of computerized and psychological “accounting research” are themselves suitable subjects for examination. We will encourage and assist all who are willing to travel the arduous path that leads to historical enlightenment; our only admonition is that preparation for the journey involves an
understanding of the nature of historical method, and a commitment to intellectual rigor.

Kenneth S. Most,
Florida International University,
July 1, 1984
Abstract: The debate among accounting theoreticians as to the content and usefulness of the Financial Accounting Standards Board’s concept statements and its conceptual framework project can better be understood if a perspective of prior "framework" efforts is used. This paper interprets the principal prior efforts to produce a comprehensive conceptual framework for financial reports down to the time the FASB was formed in 1972. It shows that previous efforts were slow to evolve, and to respond to environmental changes. There is also evidence that a continuing "dynamic tension" has existed between the patterns proposed by practitioner groups and those of groups of academics.

Antecedent Structures

Medieval Origins

The emergence of western market economies can be traced to about 1200 A.D., during the decline of the age of feudalism.

It is from thirteenth century Tuscany, and especially from Florence and Siena, that modern accounting takes its roots. From this period and region came the earliest business accounts in debit and credit form; as distinct from manorial and public accounts in charge and discharge form, whose history goes back to classical Greece and Rome, and even, in some respects, to ancient Mesopotamia, Egypt, Crete and Mycenae. It was Tuscans also who, by a series of insights and tentative improvements, evolved, probably by 1300, that scheme of double entry bookkeeping which is now in use throughout the civilized world as the basis of every well-ordered accounting system. . . .

The author wishes to acknowledge the helpful comments provided by Edward Coffman, Kenneth Most, and the anonymous reviewers. An early version of this paper was presented at the DR Scott lectures in 1983.
Texts appearing after 1869, when Professor Lucchini presented Luca Pacioli’s 1494 work to the Milan Academy of Accounting, were mostly content to acknowledge this treatise as the “source” of double-entry, which it clearly is not. Others found it useful to cite Pacioli’s statement “The debit must be the same as the credit . . . both must add to the same total. . . .”

The exchange transaction basis, and double entry accounting, are now fundamental elements of a market system, and provide the basis for a social role of accounting suggested in DR Scott’s *The Cultural Significance of Accounts.*

Scott foresaw the emergence of a social viewpoint which recognized scientific method and objective analysis as the unifying philosophy of our culture. “Accounting, as the primary vehicle of the scientific method, would replace the market system as the synthesis of our institutions and those of our culture.” He would not have been surprised to hear us use the term “bottom line” to describe a host of results and/or expectations in our culture.

If we are at the point of realizing Scott’s “synthesis” it must be that a series of interesting and important institutional changes have occurred in western society in the centuries between Pacioli’s treatise and its current state. It is not feasible to examine them all; however, several of them will be addressed in the historical context of American accountancy.

**Colonial and Antebellum Constructs**

The origins of American bookkeeping texts, now being traced to pre-revolutionary times, suggest that accounting in the American colonies was directly influenced by methods from England, Scotland, and the Netherlands.

Throughout this period, the forerunner of the modern “balance sheet” was most important, having evolved from the “balance account.” As companies grew larger and trade and joint ventures increased, more persons had an interest in their operations. When stock companies appeared as a more common form of business entity in the 17th century, creditors and shareholders sought data from separate statements, because direct access to the ledger was limited.

A little before this time, Simon Stevin of the Netherlands had suggested that more than a list of assets and capital (balance sheet) items should be provided. He prepared a statement of “Proof of Estate” (Assets) detailing the expense and revenue items involved in the change in capital, which was a form of income determination.
As the distinction between nominal and real accounts became understood, authors such as Thomas Jones of New York became innovators in the process of developing financial statements in the decades immediately preceding the Civil War. Chatfield concludes that the balance sheet and income statement (including the worksheet) emerged in their present form during the last 100 years. Early financial reports bear a strong "family resemblance," and represent the origins of our present disclosure system.

The Basic Accounting Equation

A Post Civil War Exposition

Historians trace the accounting equation to both European and American accounting literature in the 19th century, and even earlier. Europeans viewed the results of deducting liabilities from assets as "business capital." Americans also asserted that "capital" should be viewed as a personification of proprietorship. Thus evolved in American literature what we shall call "proprietary theory."

It is important to credit Charles Sprague in his series of articles "The Algebra of Accounts," (1880) with a complete and complex mathematical exposition of the accounting equation. When Sprague published his important work, The Philosophy of Accounts, (1908) the equation as we know it (Assets = Liabilities + Proprietorship) appeared within.

Thus by the start of the 20th century, after years of evolution, accountants employed an exchange price based proprietary theory, and a double entry methodology, and provided "statements" of nominal account balances and real account activity. The legacy of thought and method of this system underlies all that we know today and suggests a deliberate pace of conventional evolution influencing our field.

The Origin of American Standards

The First American Professional Reporting 'Standard'

In 1887 the American Association of Public Accountants, the forerunner of the AICPA, was formed. This organization resolved at the 1894 meeting to establish a reporting standard dealing with the balance sheet for American financial reports.

"Resolved, that the method of stating should be in order of quickest realization, viz:
Assets:
Cash,
Bills Receivable,
Book Accounts,
Stock in Trade,
Fixtures and Fittings,
Machinery and Plant,
Rolling Stock,
Real Estate and Buildings,
Leases, etc., etc.

Liabilities:
Direct liabilities, viz.:
Bills Payable,
Open Accounts, Loans,
etc., etc.

making total of same, and balance with the Surplus or Capital properly apportioned to the partners or stockholders as may be. 10 10

The process of acceptance of the standard was slow, given the influence of the British balance sheet tradition which listed long term capital assets first. A comment by Robert Montgomery, American born auditing author and early CPA leader, at the 1904 World Congress, on a paper by Arthur Lowes Dickinson, British born managing partner of the U.S. practice of Price Waterhouse & Company, attests to this:

Montgomery: Mr. Dickinson states that the captions are usually stated in the balance sheet in a certain order—in other words, we start with real estate, buildings, and other similar assets, and we finally come down to cash as the last item, and accounts and bills receivable as the immediately preceding item. I think that is hardly the general practice. I think the ordinary business man to whom our balance sheets go looks on it with better favor if the quick assets—the circulating assets—come first, and that among the liabilities those that are to be paid immediately should come first, such as accounts and bills payable, so that you have on the one hand the cash and accounts receivable, and the stocks on hand which are readily convertible into cash, and then follow it up with the fixed assets afterward, coming down to Good Will, and stating the same order on the other side among the liabilities. I think it
conveys the status of the business better than the form in which Mr. Dickinson has stated in his paper.11

It was also at the 1904 Congress, in Dickinson’s paper, that the accounting principles for determining profit or loss, and the format of a modern income statement, directed primarily to capital intensive industry, were established.

The Impact of Government

By the start of World War I, initial standards and principles of American balance sheet and income statement accounting and reports were in place. The standards were substantially self-determined and self-imposed. During the war years, however, as government agencies became concerned about uniform pricing and costing, accounting issues were no longer a matter of professional concern alone. At the same time, income taxation was introduced, and attention focused on developing regulations for income determination which would recognize accepted accounting techniques and concepts—principally accrual methods. A 1918 tax regulation stated: “Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income.” Such vague instructions offered a challenge to accountants, to attempt to structure a theoretical basis for income determination and to reduce the number of alternatives.

The Federal Reserve Board was also interested in improving the consistency of reports submitted to banks, which represented the major conduit for enterprise capital, in order to insure that the risks of credit granting were minimized by uniform disclosure in business financial statements. In the April, 1917 issue of the Federal Reserve Bulletin the Board published Uniform Accounting. The document was later (1918) separately reissued and retitled “Approved Methods for the Preparation of Balance Sheet Statements, a tentative proposal submitted by the Federal Reserve Board (Washington) for consideration of Banks, Bankers and Banking Associations; Merchants, Manufacturers, and Associations of Manufacturers; Auditors, Accountants and Associations of Accountants.”12 [This also serves as an early example of bureaucratic redundancy, in that the two word title of the original was “explicated” into 39 words.]

This document built upon Dickinson’s 1904 model of the income statement and further established fundamental review steps which were forerunners to auditing procedures for ledger accounts. In fact the document was almost entirely a recapitulation of an
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internal document of Price Waterhouse & Company, prepared by John C. Scobie. Government-professional cooperation in establishing broad standards for financial statements and audits can be traced to this document.

In 1929 Uniform Accounting was revised and retitled Verification of Financial Statements, and while issued under the auspices of the Federal Reserve Board, it was acknowledged by the accounting professional community to be the "accountant's bible"—a document of authority, voluntarily heeded by the members of the CPA community.

These were not the only government agencies involved in the uniformity movement. The Federal Trade Commission also supported such steps as a means of standardizing cost and pricing practices in industry, perhaps reflecting the myriad of techniques encountered in war contracts, and of assessing competitive practice violations, which it sought to curtail as it combated trust and monopoly practices.

The 1920s and 1930s: Growth and More Structure

Alfred Chandler identifies the rise of the professional manager during the post World War I period as a critical episode in the development of the U.S. industrial economy. Chandler contends that the resource allocation decisions of professional corporate managers are in fact a "visible hand" superseding the invisible hand of Adam Smith's market place. This visible hand of professional management was to be influenced by the conventions underlying accounting statements.

Writing in 1933 on a related phenomenon, the rise of the modern corporation, Berle and Means observed that the separation of owners and managers created a need for more structured reporting rules, to insure that owners received sufficient information to evaluate the performance of management. This concern reflected and amplified the concept of stewardship, which had been espoused as a principal objective of public statements.

By 1920 a stage of maturation in the American industrial market economy had been achieved. The economy had been transformed from principally agrarian to manufacturing, and the related long run shift to an urban from a rural society was irreversibly under way. Correspondingly, the CPA's role was becoming institutionalized. But the dynamics of a changing investment community were to test the flexibility of this adolescent reporting system. The growing number of small, naive, investors transformed the basic network
of capital sources during the 1920s. Anxious for transactional gains, and relatively ignorant, if not uncaring, of reporting practices, small shareholders rode the crest of a speculative surge. Thousands of small investors speculated in the boom of the 1920s. Paper fortunes appeared and evaporated in the casino-like environment of Wall Street. The outcome was disastrous. The market led to a major catastrophe in 1929. Margin calls, bank system credit policies, and an inattention to rudimentary economic factors caused confusion and, as the market plunged, the economy entered a state of depression.

Leaders of the accounting profession demonstrated concerned leadership and formed a study group to encourage the New York Stock Exchange to require certain minimal disclosure and review procedures to remedy shortcomings. A voluntary reduction of accounting alternatives was identified as a means of resolving major reporting concerns. But when the Kreuger and Toll empire collapsed in the wake of a suicide and financial scandal in the early 1930s, the government decided to wait no longer for the stock market and the related professions to act. Senate Banking Committee hearings led to mandatory registration for traded securities in 1933, the establishment of the Securities and Exchange Commission (SEC) in 1934, and annual reporting requirements for listed companies.

Thus, a short lived tradition of government and professional “cooperation” was all but swept aside by the urgency of economic crises. It would take nearly 50 years to restore the prerogatives of the profession to set its own rules in this arena. Those 50 years would be characterized by every manner of criticism, several major setbacks, experiments and failures. The spark of professional control was kept alive as members of the accounting profession, such as Arthur Carter, were able to convince Congress that the independent public accountant was more likely to provide the long term solution to reporting problems than a corps of federal auditors.

Congress incorporated a role for the independent public accountant into the registration and annual reporting processes, but reserved the right to determine principles for the SEC when these related to statements of corporations filing with the Commission.

Substantial Authoritative Support—A Procedure and a Foundation

Carman Blough, the first Chief Accountant of the SEC had proposed, and the SEC endorsed in Accounting Series Release (ASR)
No. 4, the view that accounting principles which demonstrated substantial authoritative support would be viewed as acceptable by the SEC. With the formation of the American Institute of Accountants' Committee on Accounting Procedure in 1938, and through the subsequent period of the Accounting Principles Board (APB), groups of practicing CPAs worked to reestablish the profession's right to determine its own standards within the bounds of "substantial authoritative support."

The Committee on Accounting Procedure (CAP)

The issuance of ASR No. 4 and the establishment of the CAP began a long period of debate between the SEC and the practicing public accounting profession. As the profession's first authoritative body, the CAP began by considering a broad conceptual statement.

Carman Blough recalled:

At first it was thought that a comprehensive statement of accounting principles should be developed which would serve as a guide to the solution of the practical problems of day to day practice. It was recognized that for such a statement to be of much help to the practitioner it would have to be much more comprehensive and in far greater detail than the "Tentative Statement" of the American Accounting Association [1936 AAA Statement] issued two years previously.

After extended discussion it was agreed that the preparation of such a statement might take as long as five years. In view of the need to begin to reduce the areas of differences in accounting procedures before the SEC lost patience and began to make its rules on such matters,
it was concluded that the committee could not possibly wait for the development of such a broad statement of principles.\textsuperscript{16}

**Academic Efforts**

By 1938 the academic community had twice broached the subject of a "framework." In 1936, an American Accounting Association group directed by Eric Kohler had published a brief 'normative' statement. Shortly thereafter, in 1938, under a commission by the Haskins & Sells Foundation, a 'positive' statement was completed by Professors Sanders, Hatfield, and Moore.

The fledgling American accounting academic community was now fully engaged in the quest for a set of concepts underlying principles, and in some sense was leading the investigation, perhaps to the discontent of a practicing community not entirely sure that its concerns about government takeover were resolved.

The appearance of the Paton and Littleton monograph, *Corporate Accounting Standards* (1940) added importantly to the academic framework for accounting. Written in support of the 1936 AAA tentative statement, the study was based on the fundamental assumption that accounting was an allocation process, guided by a matching concept, and principally oriented to the historical cost valuation model.\textsuperscript{17}

Sterling, writing in 1975, suggests that the thought habits of accountants are responsible for whatever rate of development is experienced in addressing change. More simply put, we are reluctant to leave the old and the familiar, and convinced this reluctance is a good thing if the change also can be seen to risk our economic self-interest as investor or advisor to investors. It is possible to assert that many contemporary thought habits were nurtured in the cradle of these two academic works—the 1936 and 1940 statements.

**Proprietary and Entity Theories**

Accounting conceptual models may be distinguished according to the method of value measurement. Should historical cost be retained, or should some form of current valuation be supported? However, the inability to resolve a valuation issue may be a consequence of the lack of understanding of the irreconcilable proprietary and entity concepts as orientation guides to reporting issues.

In 1950 Newlove and Garner summarized this as follows:
There are two possible approaches that one may take in the examination of basic accounting questions and propositions. One of these may be referred to as the "proprietary theory," and the other is generally called the "entity theory." Each of these theories is well rooted in history and each has its several supporters. The differences between the two theories are based for the most part on (1) the nature of the business enterprise, (2) the viewpoint to be taken of the fundamental accounting structure, and (3) relative emphasis to be placed on legal, economic, and accountancy concepts. Present day accountants should be particularly interested in these theories since they consciously or unconsciously select one or the other of them in deciding both major and minor questions which arise from time to time. In view of the fact that this process of selection is continually going on, there is small wonder that there are so many disputations in accounting matters. The two theories mentioned do not offer a common meeting ground, and if an accountant is not persistent in holding to one or the other, his conclusions as to matters of interest are likely to be inconsistent and unreconcilable.\(^*\) (emphasis added)

Indeed if there is inadequate recognition of these differences, a consistent resolution of reporting issues cannot be expected.

Codification as a Remedy

In 1950 the SEC began to press the Committee on Accounting Procedure for a "comprehensive statement" (codification) of its output. With the threat of the government expanding Regulation S-X, (the compendium of SEC reporting requirements), the CAP agreed to codify its own pronouncements, thus producing Accounting Research Bulletin No. 43 (1953).\(^{19}\)

The pace of activity in these pre-1960 academic, professional, and government circles should be considered positive and remarkable. Herein established are precedents for both codification and theoretical investigation while the American culture and economy absorbed the pressure of a great depression, a global war, several minor wars, rapid expansion of the practice community, and increasing sophistication and diversification among user and preparer groups.

Furthermore, the academic community of the period was actively exploring alternatives to proprietary and entity orientations. New
"master" concepts were being proposed to reflect the increasing scope of accounting disclosure and the perplexing reporting problems related to corporate conglomerates. Writing in 1947 Vatter argued that the two traditional models of orientation were outmoded. He called for serious consideration of an alternative, a fund theory of accounting.\textsuperscript{20} Moonitz identified both the corporate entity and consolidated reporting as focal points of concern and suggested more study of the implications of his "entity" theory.\textsuperscript{21}

The fundamental preoccupation with proprietary and entity views however was not overcome, even though David Solomons, writing in 1961 observed: "...just as in the first half of this century we saw the income statement displace the balance sheet in importance, so we may now be de-emphasizing the income statement in favor of a statement of fund flows or cash flows...my own guess is that, so far as the history of accounting is concerned, the next twenty-five years may subsequently be seen to have been the twilight of income measurement."\textsuperscript{22}

\textit{Developing a Research Basis}

During the period, the CAP had seemed prepared to leave conceptual propositions to academics. But in 1958, the AICPA Special Committee on Research Programs recommended the formation of the APB and a research basis for the APB's deliberations. A substantial conceptual effort was then mounted under the sponsorship of the practice community, when as Moonitz tells:

Two research projects were expressly called for in the special committee's report: the "basic postulates" research study did not evoke much reaction from the APB or the profession generally at the time of its publication... The Sprouse-Moonitz (principles) research study appeared at the end of April 1962. Each copy of the research study contained a statement by the Accounting Principles Board (now referred to as APB Statement No. 1). The statement contained a key sentence "The Board believes, however, that while these studies (i.e., the first and third research studies) are a valuable contribution to accounting thinking, they are too radically different from present generally accepted accounting principles for acceptance at this time..."

Research Studies Nos. 1 and 3 were rejected as too radical. Accounting Research Study (ARS) No. 7 (Grady,
An Inventory of Generally Accepted Accounting Principles, March 1965) however, was apparently what the APB wanted. . . . With one or two exceptions, it provided the kind of codification the Special Committee on Research Programs had in mind."23

In October 1970 APB Statement No. 4, identified as descriptive and not prescriptive, and binding on no one for any purpose whatsoever, was issued by the APB. Entitled “Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises”; it went over much the same ground as Grady's work. It failed however to satisfy the need for a comprehensive authoritative statement of Generally Accepted Accounting Principles (GAAP).

New Academic Proposals

A few years earlier (1966) academics had issued A Statement of Basic Accounting Theory (ASOBAT) under the auspices of the American Accounting Association. ASOBAT called for, among other things, both historical and current cost information. It seemed necessary that the practicing profession should respond to the academic position that more than historical cost measurement was called for in financial statements. Building on prior research (Accounting Research Study No. 6, 1963), the APB concluded in Statement No. 3 (June 1969) that: "The Board believes that general price-level information is not required at this time for fair presentation of financial position and results of operations in conformity with generally accepted accounting principles in the United States."24

The publication of Accounting Research Studies Nos. 1 and 3 had challenged the comfortable thought habits of the times when they appeared in the early 1960s. Grady's ARS No. 7 and the APB's Statement No. 4 had a more comforting effect on the profession. The familiar and the practical triumphed over new and abstract proposals. Grady and the APB had credibility as they were identified with the practice community. The work of Moonitz, Sprouse, and ASOBAT were, perhaps “guilty” of being too novel, and too academic.

In late 1970 however, academics once again returned to address the issue. The AAA formed a study group, the Committee on Establishment of an Accounting Commission.6 It was charged to consider the feasibility and desirability of establishing a Commis-

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6One of the few places the charge and the list of the membership appears is in The Accounting Review, January, 1971, p. 174.
sion to study and recommend an organizational structure for (a) advancing the formulation and modification of generally accepted accounting principles and (b) the issuance of authoritative pronouncements concerning the application of such principles.

The deliberation of this Committee, chaired by Solomons, coincided with parallel formative actions being explored by an *ad hoc* professional group. The AAA group concluded its ‘catalytic’ efforts, and Solomons became a principal draftsman of the AICPA's Wheat Committee report. This Wheat (Solomons) Committee called for the creation of a Financial Accounting Standards Board, and for broader representation in determining GAAP in that practicing public accountants were joined by representatives from other constituencies of the financial community. Simultaneously with the formation of the Wheat (Solomons) Committee, the Trueblood Study Group on “Objectives of Financial Statements” began its work. George Sorter, another academic, served as its Research Director. He had also been one of the members of the short-lived Solomons AAA Committee.

The results of the Trueblood (Sorter) study group were to assert these “normative” propositions:

- The basic objective of financial statements is to aid in economic decision making.
- Financial statements should:
  - Assist in predicting, comparing and evaluating the earning power of enterprises.
  - Report both historical cost and current values which differ significantly.
  - Separate information which is factual from information which is interpreted.25

**Conclusion**

This excursion into the evolution of the intellectual architecture of American accountancy has attempted to establish a point of reference for contemporary consideration of the FASB's conceptual framework project. It suggests that we recognize the continuing philosophical differences of view between government, academe, the practicing profession, and investor groups in seeking what some would suggest is the “negotiated truth” of accounting standards. A summary point, and an important one, is that a dynamic tension has existed almost continuously between academic and practice elements as to the composition of a comprehensive conceptual model. These tensions have provoked activity which has
brought us to a threshold of an important event—the measurement component of a financial reporting framework of the Financial Accounting Standards Board.

Nearly a decade ago, Sprouse, keeping in perspective his role as co-author of ARS No. 3 ten years previously, remarked:

The assertion is frequently made that in accounting's house the income statement is our most important product. To the extent that this is intended to mean the attention of most users of financial statements tends to focus on the income statement, the assertion is acceptable. To the extent that the assertion refers to the most important elements of accounting theory, the assertion is delusory. This paper is written in support of an alternative proposition; (emphasis added) the balance sheet embodies the most fundamental propositions of accounting theory, from which the essential elements contained in the income statement can properly be described as merely a summary of one class of transactions resulting in changes in one balance-sheet account.26

Sprouse is now a member of the Financial Accounting Standards Board. How much of this view represents Sprouse's thoughts today? How much of it will underlie the measurement component of the conceptual framework of the Board?

American accountancy has evolved without an exclusive/comprehensive framework for financial accounting thought. We have negotiated and then legislated, in some fashion, our truths for at least as long as we have been an organized profession. The potential for an FASB sponsored single comprehensive theoretical framework for financial reporting, therefore is limited by the historical view of such conceptual undertakings. But the transitory quality of the past can change if constituent groups begin to recognize the inherent limitations of general purpose reports, and embrace the usefulness of multi-valuation disclosure.

FOOTNOTES

1Lee, 1972, p. 28.
2Pacioli (Crivelli), 1924, p. 32.
3Scott, 1931, p. 7.
4Elam, p. 39.
6Chatfield, 1977, p. 222.
7Most, 1982, pp. 44-45.
8Sprague, 1880.
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9 Sprague, 1907, p. 23.
11 Dickinson, 1904, p. 196.
12 Federal Reserve Board, 1918, title page.
13 Previts and Merino, 1979, p. 189 and DeMond, p. 125.
15 See Berle and Means, 1933.
16 Shenkir, 1979, p. 175.
17 Moonitz, 1974, p. 16.
19 Kohler, 1951, p. 51.
20 Vatter, 1947, Ch. I.
21 Moonitz, 1951, p. v.
23 Moonitz, 1974, p. 28.
24 APB Statement No. 3, par. 25.

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THE PENSION ACCOUNTING MYTH

Abstract: This paper traces the development of pension accounting theory and practice to 1930. It analyzes the early development of pension accounting theory and practice, examines explanations of the nature of pension costs, and reports the results of a survey of pre-1930 pension disclosure practices.

The Financial Accounting Standards Board's employer pension accounting project has been described as "one of the most important undertaken since the Board was established in 1973." Analyses of the project follow a standard format of (1) describing the pension pronouncements of the Accounting Principles Board (APB), (2) discussing the pension reform legislation of the 1970s and 1980s, and (3) criticizing the FASB's proposals for change. Absent is any consideration of pension accounting theory and practices developed between the establishment of the first U.S. private, pension plan in 1875 and the 1966 Accounting Principles Board Opinion No. 8. This omission underscores the myth that pension accounting theory and practice did not begin to develop until the advent of pension regulation.

To refute this myth, this paper reviews pension accounting theory and practice during the unregulated period prior to any pronouncement by the Accounting Principles Board, the securities laws (1933, 1934), the Social Security Act (1935), and much of the tax legislation directed at private pension plans (1928 and thereafter). This approach eliminates, or at least minimizes, the effects of regulatory influences.

The paper contains four sections each directed at one of the following questions:

(1) What factors affected the early development of pension accounting theory and practice?
(2) What theories existed to guide measurement and disclosure?

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Factors Affecting The Development of Pension Accounting Theory and Practice

The first formal, noncontributory pension plan was established in 1875 by the American Express Company. Under the terms of the plan, employees sixty years of age or over who had worked continuously for the company for at least twenty years, and who were judged by the general manager to no longer be able to do their work, could be retired by the executive committee of the board of directors. The annual pension allowance was one-half of the employee's average annual pay during the 10 years preceding retirement, to a maximum of $500. Average annual pay being $439 for manufacturing employees and $560 for railroad employees, most pensioners would have received less than $300 a year in benefits.

The number of new pension plans grew relatively slowly during the next fifty years. In 1929, there were only 397 pension plans operated in the U.S. and Canada. The growth rate accelerated over the next decade, and by March 31, 1945 over 7,500 plans had been submitted to the Bureau of Internal Revenue for advance rulings on their tax status.

The growth of the private pension system was caused by industrialization and changing demographics. Procedures to account for these plans were influenced by (1) the types of plans, (2) employer motives for establishing the plans, (3) managerial philosophy, (4) financial considerations, and (5) legislation and judicial decisions.

Types of Plans

Early pension plans can be classified as informal or formal. In informal plans, there were no standards for granting benefits. Payments were made on the basis of the employer's assessment of need rather than using standardized criteria. Because of their lack of structure, there was rarely a written record of how these plans operated. Accordingly, it is difficult to determine the extent or importance of these plans.

Formal plans have written (or unwritten but consistently followed) rules governing eligibility requirements, computation of benefits, and other procedures. Annual reports and labor records often provide insights into the operation of these plans. With formal plans...
labor records usually show a steady rather than erratic pattern of employee retirements each year.

Within the category of what are now called defined benefit plans, formal plans are broadly classified as noncontributory or contributory. The former meant that the employee made no cash contribution to the plan and the latter that he contributed regularly from his cash wages.

Noncontributory plans were further distinguished as “discretionary” or “limited-contractual” plans. Employers sponsoring noncontributory “discretionary” plans had complete, unquestioned control over the general provisions of the plan, the amount of benefits, the continuance of the plan, and the continuance of the pension once payments began. This type of plan has been described as saying to the worker:

- If you remain with this company through your productive lifetime,
- If you do not die before the retirement age,
- If you are not discharged, or laid off for an extended period,
- If you are not refused a benefit as a matter of discipline,
- If the company continues in business, and
- If the company does not decide to abandon this plan,
- you will receive a pension at the age of _____, subject to the contingency of its discontinuance or reduction, after it has been entered upon.7

With one exception, this description also applied to “limited-contractual” plans. The exception was that under a “limited-contractual” plan, pension payments to an employee could not be discontinued once they were begun. A 1922 study of eighty-seven noncontributory plans indicated that only twenty-seven were “limited-contractual” plans.8

In the majority of noncontributory plans, computation of benefit payments was directly related to an employee’s pay during the final years of his service to the employer.9 This type of plan, commonly called a final pay plan, is still prevalent today.10

**Motives and Managerial Philosophy**

The discretionary nature of early pension plans suggests that payments made under these plans may have been viewed as gifts or rewards. This conclusion is supported by early plan descriptions which characterize pension payments as “voluntary gifts from
the company" but it is at odds with analyses of employers' motives for establishing pension plans.

A 1922 critique of industrial pension plans lists five motives for establishing a plan.

- A desire to provide for the old age dependent, superannuated employees.
- A desire to reward employees who have rendered unusually long service.
- A desire to increase efficiency, first by the elimination of superannuated or incapacitated workers on a humane basis and, second, by stimulating the good will and effort of the active force.
- A desire to hold the worker to the job, thereby reducing labor turnover.
- A desire to exercise a disciplinary control over workers in response to strikes and in other ways.12

After lengthy discussion, the critique concludes that the "one controlling justification of a pension system from the employer's standpoint is that it will increase efficiency, primarily through elimination of superannuated and incapacitated workers, and possibly by building up a larger amount of good will and interest among the active force."13 This conclusion is supported by the fact that formal pension plans developed most rapidly in industries (e.g., railroads, heavy manufacturing) in which older workers normally would not have the physical strength or agility to perform the physical tasks required by their jobs.

Economic factors also were used to explain why the majority of employers established noncontributory rather than contributory plans. One critic provided the following analysis:

If the dominating influence were the desire for a humane method of retirement, there would seem to be no reason against the employees contributing to a fund and having a voice in administration. That they do not do so leads to the conclusion that the railroads have preferred to bear the entire cost in order to retain full control of the schemes. This policy has the advantages, at least in the opinion of the management, of not complicating relations with trade unions, retaining full control of retirements and final judgment on the fulfilling of qualifications, discouraging strikes, and permitting retirement for the good of the service and the public safety.14
The emphasis on economic efficiency indicated in the foregoing quotes is consistent with a management philosophy of the early part of the twentieth century referred to as scientific management. Proponents of this philosophy looked at business organizations from a highly mechanistic view and saw workers as tools for achieving rational, profit-maximizing goals.\(^{15}\)

Although employers viewed pension plans as a means of improving labor productivity, the general attitude of workers toward early pension plans was one of indifference or distrust. Labor leader Samuel Gompers described organized labor's position as follows:

> Labor does not believe in pensions given by the employer. Old age pensions were established by a number of railroad companies, not for the benefit of their employees primarily but for the influence they might have on discouraging organization. \(...\)^{16}\n
Labor's negative attitude toward pensions, which continued until the cash wage freezes of the 1940s, supports the contention that early pension plans were designed to meet the economic needs of the employer rather than those of the employees.

**Financial Considerations**

Concern for the financial health of industrial pension plans surfaced early. In 1922, for example, Conant stated, "very few of the industrial pension plans in the United States today are so financed that they are likely to remain solvent without refinancing or modification."\(^{17}\) Latimer's study concluded, "the great majority of pension plans in American industry have been established with no accurate calculation of their future costs and with no adequate provision for financing them."\(^{18}\)

Factors cited as contributing to these problems included (1) absence of actuarial calculations of prospective payments, (2) failure to establish segregated pension funds, and (3) the use of salary-related benefit formulas.

**Legislation and Court Decisions**

Employers had almost total discretion in the administration of early pension plans. Initially, this discretion was not an issue of public policy. The early tax laws, for example, did not require nondiscrimination in the payment of benefits or irrevocability of contributions as conditions for the tax deductibility of pensions paid to retired employees or contributions to a trust to fund current
pension credits. They also did not permit the deduction of payments to a trust to fund credits for past service or to put the trust on a sound financial basis. The latter type of deduction was first permitted by the Revenue Act of 1928.

The right of employers to unlimited discretion in plan administration was supported by a series of court decisions. The main question adjudicated was whether the offer of a pension constituted an agreement to pay when specified conditions were fulfilled or whether it was merely an offer of a gratuity which could be withdrawn by the employer at will. Since there was no statutory law on the subject, early court decisions represented the only source of authority on the contractual status of a pension arrangement. Latimer's analysis of major cases prior to 1930 concluded "the trend of the law so far has been to say to industry that it make its own law for pensions. The court will take the pension plan as the statute in each case and decide in accordance with it." This meant that the amount due was generally not deemed to be compensation and the fulfillment by the employee of his part of the agreement was not regarded as the consideration necessary for completion of a contract.

Implications for Accounting

The factors reviewed in the preceding subsections have conflicting implications for the development of pension accounting theory and practice. On the one hand, the emphasis on economic efficiency, scientific management, and the financial health of pension plans provided incentives for the development of fairly detailed records to determine the cost of providing pension benefits. On the other hand, however, the emphasis on employer control of pension plans shown by managerial practices, court decisions, and tax laws would have militated against the development of relatively uniform and consistently applied accounting rules.

The next two sections indicate how this conflict was resolved. The first examines the early pension-related accounting literature, and the second, the pension accounting practices that evolved.

Development of Pension Accounting Theory

Two theories were developed to explain who bears the cost of providing pension benefits. One, the deferred wage theory, argued that employees actually financed their own pensions by accepting pension promises in lieu of cash wages. The other contended that it was the employer who bore the entire cost of the plan.
The deferred wage theory is based on the premise that pension promises are part of the total compensation package offered employees. Since the total value of the compensation package is fixed by the market, an increase in the pension component would be offset by a decrease in the cash wage. An early proponent of the deferred wage theory argued, "a pension system considered as part of the real wages of an employee is really paid by the employee, not perhaps in money, but in foregoing an increase in wages which he might obtain except for the establishment of a pension system."\(^{20}\)

The Illinois Pension Laws Commission reached a similar conclusion. Their report noted,

It is the opinion of students of the pension problem that the existence of a pension system in connection with any position of employment is taken into account by both parties to the contract of employment, and that broadly speaking, wages and salaries actually paid are in due course reduced below what they otherwise would be by the amount of the total contributions from both the employer and employee to a pension fund. The employee will thus pay for his pension by deductions from his wages or salary, whether he is conscious of it or not.\(^{21}\)

The competing theory refutes this position and argues that a pension contribution is similar to a charge for depreciation or insurance. A proponent of this view noted:

in so far as such a payment is for insurance against that waste and inefficiency in his establishment which would result from retaining superannuated employees and for protection against that discontent which would result from discharging the superannuated without providing for them financially, it is part of the business expense.\(^{22}\)

A similar position to the latter was adopted in the first pension accounting article to appear in the *Journal of Accountancy*. To the author, pension plans were an operationalization of the philosophy of scientific management. Employers bore the additional cost of the plans because they expected them to help increase profitability. However, the cost was not viewed as a production cost. Rather, it was viewed as a separate charge against income, or a form of profit-sharing. Appropriate accounting meant that "pensions should be provided for in a reserve, during the period of activity of
the employee, and, like Bonus and Profit-sharing, be treated as a regular expense of business."23

Hatfield also advocated including among expenses "the amount necessary to provide for future pensions."24 In addition, he questioned whether employers with pension plans should recognize a balance sheet liability. He concluded that the answer depended on "the exact legal nature of the pension agreement and on the financial policy adopted in its administration."25 He argued that unless a definite legal liability existed, an amount equal to the sum in the pension fund, should be regarded as a reserve rather than a liability.

Hatfield noted that if annual contributions were made to a trustee, neither assets nor a reserve needed to be shown on the balance sheet. He reasoned that in such cases the payment of wages consisted of two parts: a cash wage paid to the workman and a cash contribution made to the trustees. According to Hatfield, no further accounting was necessary after the cash payments were recorded.26

Like Rand and Hatfield, Whitmore recommended accrual accounting for pensions. His recommendation was based on the premise that pension promises are part of the total cost of labor. In a 1927 Journal of Accountancy article, highly critical of industrial pensions, he argued,

The real troubles are lack of actuarial calculations and of funding; or in plainer words, ignorance of the long-continued increase and the ultimate annual burden of pension payments, and neglect of the principle that the cost of pensions, as a part of the cost of labor, needs to be accrued, year by year throughout the years in which labor is performed.27

Whitmore intended for each year's cost accrual to be fully funded. He reasoned that to do otherwise would render the plan financially unsound and understate the cost of production.

A subsequent article by Whitmore focused on the implications of the deferred wage theory of pensions. Whitmore argued that "it is fairly certain that what the workers receive as pensions they will not receive as wages. And there is this great difference, that wages are likely to be fairly distributed as earned, and pensions are not."28 Whitmore thought that employers should raise cash wages to allow employees to provide for their own retirement rather than promising pension benefits. He concluded his arguments by predicting the eventual demise of industrial pensions:
[employee savings plans] would accomplish far more good than pension systems, at least in manufacturing industry, and be free from all of the evils affecting both employer and employees, that seem inseparable from pension systems.

It is, therefore, through rising wages based upon accounting measurements of economies in manufacturing, and through the maximum encouragement and scientific management of savings, . . ., that I believe the need for pension systems in manufacturing industry should gradually cease. 

In contrast to Whitmore, Kimball supported the proposition that pensions are necessary to maintain efficiency in a continuously operating organization. He criticized the practice of charging pension payments to a supplementary payroll and treating them as a period operating cost. He argued pension cost was a production cost and that it was “logically inescapable that production cost is properly chargeable at the time goods or services entering into production are used, and not at the time they are paid for.” The amount of pension cost would be “the present worth of the future pension liability arising in any year out of that year’s service.” In other words, it would be an amount equal to the normal cost of an actuarial cost method that took into consideration factors such as mortality, turnover, and future salary levels.

Although Kimball advocated annual pension accrual, he did not advocate the segregation of assets in a separate pension fund. He argued, “sound pension accounting and sound pension practice do not require the segregation of the money out of which pensions will eventually be paid, any more than the meeting of other obligations requires the segregation of money for its liquidation.” He reasoned that showing a balance sheet reserve was sufficient.

Kimball attributed the lack of attention given to pension accounting by employers to the fact that pension plans are non-contractual. He supported this statement by noting that “many executives of important businesses, which have for years made regular disbursements, have told me that since the pension was a voluntary matter, determined in amount and terms at the date of grant, future pension payments did not constitute an obligation that could properly be considered a balance-sheet item.” Kimball acknowledged the technical accuracy of this position, but advocated reporting the pension reserve as a liability in the balance sheet.
Dicksee discussed the use of reserves in accounting. His discussion distinguished reserves and reserve funds. A reserve was "a provision charged against profit with a view to covering an expected loss." Although Dicksee used the term loss in his definition, his example of creating reserves for the estimated amount of uncollectible accounts suggests that his use of the term encompasses provisions for estimated expenses. Thus, the creation of a reserve involved a debit to an expense or loss account and a credit to a reserve account.

Dicksee indicated that the reserve should be treated as a deduction from the particular asset in respect of which it was created or as a liability if created to cover a general loss (estimated expense) in respect to all assets. Although Dicksee did not specifically address the use of reserves in pension accounting, it appears as though a pension reserve would have been shown as a liability rather than a deduction from a specific account such as cash.

In contrast to a reserve, a reserve fund was "a sum set aside out of divisible profits, and retained in hand for the purpose of strengthening the financial position of the undertaking." A Reserve Fund is but a portion of the credit balance of the Profit and Loss Account, which has been specifically "earmarked" as being "reserved." Inclusion of a Pension Fund Reserve in the balance sheet indicated to shareholders that the fulfillment of pension promises would make a certain amount of earned surplus unavailable for the payment of dividends. In other words, it indicated there was an appropriation of retained earnings.

A Survey of Pension Disclosures

Pension accounting practices of employers prior to regulation have not been well documented. The fact that published articles argued how pensions should be accounted for suggests that practicing accountants may have been using a variety of approaches. To gain insights into the pension accounting and disclosure practices of employers, a sample of companies sponsoring pension plans in the early twentieth century was selected from a list of companies starting pension plans before 1922. From this list, it was possible to locate sets of pre-1930 annual reports for the following companies: American Sugar Refining Company, American Smelting and Refining Company, J. I. Case Threshing Machine Company, Colorado Iron and Fuel Company, Deere and Company, Diamond Match Company, International Harvester, Pittsburgh Coal Company, and U.S. Steel. The annual report for each company for each year available was examined for pension disclosures.
Table 1 summarizes the results of the examination.* It indicates the types of disclosures the individual companies made. The majority of the companies studied tended to provide quantitative and relatively detailed qualitative pension disclosures. Only three of the companies (Colorado Fuel and Iron, J. I. Case Threshing Machine, and Diamond Match) did not provide disclosures that gave insights into the operation of their pension plans and the systems used to account for them.

In some cases, the disclosures voluntarily made provided basically the same information that was later required by regulation. For example, the 1911 annual report of the American Sugar Refining Company included a three page description of the provisions of the company's newly adopted pension plan. The description indicated who would receive benefits, how they would be earned, and how the amounts of benefits would be computed. This type of information, which also was disclosed voluntarily by American Smelting, International Harvester, and U.S. Steel, is what the federal government now requires in summary plan descriptions filed with the Department of Labor under the Employee Retirement Income Security Act.

Although several companies discussed the computation of pension cost, it was frequently difficult to determine how the cost was computed. Rather than discussing cost in their narrative disclosures, the companies tended to focus on absolute amounts, e.g., how many employees were receiving benefits; how much did they receive during the current period and to date; and how much was appropriated for the plan.

The majority of the companies used a reserve to account for their pension commitments. Figure 1 shows the pension reserve disclosures made by International Harvester in its 1918 annual report. A reconciliation of beginning and ending reserve balances was also provided in the annual reports of Pittsburgh Coal and U.S. Steel.

Several variations of reserve accounting existed. Journal entries for two of the variations are shown in Figure 2. Under both, the amount initially credited to the reserve was likely to be determined without the use of actuarial calculations. The amount credited to the reserve each year, if any, often was determined by the profitability of the company during the year. The reserve may have been designated as relating only to pensioners or as relating to the active work force as well as pensioners. The practice of pension reserve

*Copies of the detailed analyses of disclosures for each year are available from the author.
Table 1
Some U.S. Pension Disclosure Practices Prior to Regulation

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<td>Qualitative Disclosures</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Employer's pension philosophy</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Plan description</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Discussion of plan changes</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Number of pensioners</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

*Measure generally is not the result of an actuarial cost method consistently applied—see discussion.

accounting was followed by large companies, such as U.S. Steel, throughout the war years and into the 1950s.

With variation 1 (Figure 2), the entry to create the reserves was simply a reclassification. In effect, it was an appropriation of earned surplus (i.e., retained earnings). According to Dicksee, the credit should have been to Pension Reserve Fund rather than Pension Reserve. However, the companies studied did not always make this distinction. A companion entry may or may not have been made to segregate cash in a special fund. If a fund was established, earnings of the fund were used to pay pensioners. To the extent that fund earnings were insufficient to cover payments or if no fund existed, pension payments were recorded as a charge to operating expense. Debiting pension expense for the amount paid to pen-
Pension Fund:
A permanent Pension Fund is established by annual appropriations from earnings, to be continued until its amount is sufficient to provide the income necessary for future payments. Pensions are paid by the Company without any contribution from employees. The appropriation made by the directors from 1918 earnings was $1,000,000, which has been invested in Liberty Bonds.

On January 1, 1919, the pension plan rules were amended to conform more closely to changed living conditions. The minimum pension was increased from $21 per month to $30 per month. The maximum pension was increased from $100 per month to $208.33 per month, with the limitation that in no case shall a pension exceed one-half of the average annual pay. The Pension Board was authorized to increase the rate of monthly payment to pensioned employees from 1% to 1½% of the average annual pay for each year of active service; also to make the basis of calculating the average annual pay the consecutive ten-year period in which the employee received the highest pay, instead of the last ten years of service, as heretofore. These changes will materially increase the total annual pension distribution. At December 31, 1918, there were 365 former employees on the pension roll.

Balance at December 31, 1917:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Harvester Co. of New Jersey</td>
<td>$2,336,762.94</td>
</tr>
<tr>
<td>International Harvester Corporation</td>
<td>856,092.57</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,192,855.51</strong></td>
</tr>
</tbody>
</table>

Add:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from Fund for year 1918</td>
<td>157,107.49</td>
</tr>
<tr>
<td>Appropriation from 1918 Earnings</td>
<td>1,000,000.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$4,349,963.00</strong></td>
</tr>
</tbody>
</table>

Deduct:

<table>
<thead>
<tr>
<th>Source of Funds</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension payments during 1918</td>
<td>112,572.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$4,237,391.00</strong></td>
</tr>
</tbody>
</table>

Figure 2

Journal Entries for Reserve Pension Accounting

<table>
<thead>
<tr>
<th>Entry</th>
<th>Variation 1</th>
<th>Variation 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>To establish or increase the pension</td>
<td>Earned Surplus</td>
<td>Pension Reserve</td>
</tr>
<tr>
<td>reserve</td>
<td>Pension Reserve Fund</td>
<td>Expense</td>
</tr>
<tr>
<td></td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>To purchase investments, if plan</td>
<td>Investments, Pension Fund</td>
<td>Investments, Pension Fund</td>
</tr>
<tr>
<td>funded</td>
<td>Cash</td>
<td>Fund</td>
</tr>
<tr>
<td></td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>To record investment earnings</td>
<td>Cash</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td>Pension Reserve Fund</td>
<td>Pension Reserve</td>
</tr>
<tr>
<td></td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>To record payments to pensioners</td>
<td>Pension Reserve Fund</td>
<td>Pension Reserve</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td>Current Operating Expense</td>
<td>XX</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>XX</td>
</tr>
</tbody>
</table>

With variation 2 (Figure 2) pension expense was charged each time the reserve was increased. If the increase was related to the assumed cost of pensions earned during the year, the employer was accruing pension costs. If an increase was made only in profitable years, however, the concept of accrual accounting was violated and the reserve served as a means of smoothing income. Under this variation, pension payments generally were charged to the reserve rather than expense. The pension fund, if any, was reported as a balance sheet asset and the reserve was included with long-term liabilities, frequently as part of an amount captioned general reserves.

A number of companies provided detailed analyses of their pension funds until around 1928. Figure 4 shows a pension fund statement from the 1922 annual report of Pittsburgh Coal Company. The fund statement agreed with the company's financial statements. The $216,004.98, indicated by (1), was carried as a noncurrent asset on the balance sheet. The $215,301.77, indicated by (2), was shown as a gross receipts deduction in the profit and loss statement.

In 1928 pension funds and reserves began to move off the balance sheet. The prime factor associated with this movement was the Revenue Act of 1928. This act permitted an employer to take deductions for reasonable amounts paid in to a qualified trust in excess of the amounts required to fund current liabilities, This
The American Sugar Refining Company
and Its Constituent Companies
Condensed General Balance Sheet, December 31, 1917

ASSETS:

Real Estate and Plants, including Refineries, Warehouses, Coop-
erage, Railroads, Tank Cars, Wharves and Stables, with their
machinery and equipment, and timber and other lands owned
in fee or through ownership of the entire Capital Stock of con-
stituent companies, at cost less depreciation $45,931,123.93
Investments, General ................................................. 24,782,540.68
Investments, Insurance Fund ............................... 9,500,000.00
Investments, Pension Fund .................................... 1,750,000.00
Merchandise and Supplies, including raw and refined sugar,
syrup, material in process of manufacturing, boneblack, coop-
erage and other stock and supplies on hand ................. 9,142,074.71
Prepaid Accounts, Insurance, Taxes, Etc. .................. 309,051.18
Loans .......................... 1,121,266.10
Accounts Receivable ............................................. 3,322,489.23
Accrued Income, Interest earned and dividends declared but not
yet collected ..................................................... 1,047,043.91
Cash on hand, with Trust Companies, Banks and Short-term
Loans .............................................. 40,493,252.19
$137,398,841.93

Capital Stock:
Preferred $45,000,000.00
Common 45,000,000.00
$90,000,000.00

Sundry Reserves:
For Insurance .................................................. $9,500,000.00
For Pension Fund ............................................. 1,750,000.00
For Improvement of Plants ................................. 3,367,514.84
For Trade Mark Advertising .............................. 2,000,000.00
For Contingencies ........................................... 823,647.99
17,441,162.83

Accounts, Taxes and Loans Payable ........................ 8,097,115.45
Dividends declared payable January 2, 1918, and former divi-
dends unclaimed ............................................. 1,599,036.75

Surplus:
Balance December 31, 1916 ................................. $18,348,711.69
Add Amount transferred in 1917 as stated in In-
come and Profit and Loss Statement .................. 1,912,815.21
$20,261,526.90
$137,398,841.93

et al.: Accounting Historians Journal, 1984, Vol. 11, no. 2

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Figure 3 (continued)
1917 Balance Sheet of The American Sugar Refining Company and Its Constituent Companies

The American Sugar Refining Company

and Its Constituent Companies

Income and Profit and Loss Statement for the Year 1917

CREDITS:

- Profit from Operations $10,055,291.41
- Interest on Loans and Deposits 1,006,002.25
- Income from Investments, less Decrease in Market Value of Bonds, and of Securities held for temporary investment 3,129,948.70
- Net Profit from Investments 21,544.85

$14,212,787.21

DEBITS:
- For Depreciation, Renewal or Replacement of Plant and Equipment $2,000,000.00
- For Appropriations to Reserves as follows:
  - Insurance Fund $500,000.00
  - Improvement of Plants 2,000,000.00
  - Trade Mark Advertising 1,000,000.00
  - Pension Fund 500,000.00

4,000,000.00
- For Dividends declared during 1917 6,299,972.00
- Balance added to Surplus 12,299,972.00

$1,912,815.21

We have examined the books and accounts of The American Sugar Refining Company and the statements of the several constituent companies, and verified the cash, the loans and the securities owned. The foregoing Condensed General Balance Sheet and Income and Profit and Loss Statement agree with the said books and accounts. We are of the opinion that ample reserves have been made for depreciation or for renewal and replacement of fixed assets and for other purposes, including taxes; that the value of the investments, as a whole, is conservatively stated and the foregoing Condensed General Balance Sheet presents the true financial position of the corporation and its constituent companies on December 31, 1917.

GEO. H. CHURCH, C.P.A.,
DELOITTE, PLENDER, GRIFFITHS & CO.,

Auditors

New York, February 11, 1918

Figure 4
Detailed Pension Disclosures from the 1922 Annual Report of Pittsburgh Coal Company

MINE EMPLOYEES' PENSION FUND

Cash on Hand at January 1, 1922 ...................... $ 8,348.54

RECEIPTS
Company and Employees Contributions .................. $ 6,217.92
Interest and Dividends from Investments ............... 18,525.33

Total RECEIPTS ................................................. 24,743.25 (3)

DISBURSEMENTS
Pensions Paid ................................................. 33,795.00
Decrease during year ........................................ 9,051.75
Less—Advance from Employees’ Relief Department ........................................ 703.21

Cash Balance at December 31, 1922 ...................... $ 8,348.54

INVESTMENTS AT DECEMBER 31, 1922

3000 Shares Preferred Stock of the Company—cost $211,004.98
4¼% United States Liberty Loan Bonds— .......... 5,000.00

Total INVESTMENTS ............................................ $216,004.98 (1)
Less—Advance by Mine Employees' Relief Department ........................................ 703.21
Balance at Credit, December 31, 1922 ................. (2) $215,301.77

NUMBER OF MINE EMPLOYEES RECEIVING PENSIONS

At January 1, 1922 .......... 166
Added during year .............. 37
Deaths during year ............ 18

At December 31, 1922 .......... 185

meant that, for the first time, employers were able to take deductions for payments to fund past service liabilities. The employers in the current study responded to this incentive by transferring their balance sheet reserves to a trust.

The following explanation was provided in the 1928 annual report of International Harvester.

On December 13, 1928, the directors approved the trusteeing of the Pension Fund and before the issuance of this report a Pension Trust was executed and Fund assets transferred to trustees. Accordingly, the Pension Fund and the contra reserve have been omitted from the balance sheet.

The heavy future obligation involved in the maintenance of a pension plan can be safely financed only by setting aside during the employee's productive years the fund to pay his pension after retirement. The Company follows this plan and the Pension Fund assets now trusteed are required to meet the estimated accrued pension liability at December 31, 1928. It is expected that such additional amounts as the directors may hereafter appropriate for pension purposes will also be transferred to the Pension Trust.

Establishment of a trust allowed an employer to take advantage of tax incentives, but the then current laws did not require that the trust be irrevocable. This meant that an employer could make substantial tax deductible contributions to a trust during years of high earnings and recapture the earnings in poor years by revoking the trust. The requirement that pension trusts be irrevocable did not become law until the Revenue Act of 1938. Nonetheless, the establishment of trusteed plans was associated with a decrease in voluntary pension disclosures.

Summary and Conclusions

This paper refutes the myth that pension accounting theory and practice developed after the advent of regulation. By 1930, competing pension theories had been articulated and a body of pension accounting literature had begun to develop. The literature focused on the importance of the accrual of pension costs, a practice that was not mandated by the Accounting Principles Board until 1966. The early literature also raised the question of whether an employer's pension promises constituted an obligation that warranted
balance sheet recognition, a question currently being debated by the Financial Accounting Standards Board.

Although early writers devoted little attention to the question of pension disclosures, a survey of pre-1930 annual reports showed that some of the companies studied made extensive pension disclosures. Before there was any external requirement to do so, employers disclosed relatively detailed information about the terms of their plans and the reserves accumulated for those plans. Although measures of pension costs were disclosed, explanations of their method of computation often were missing, or ambiguous.

Documentation of the existence of voluntary pension disclosures opens the door to a number of questions of potential interest to academic researchers and policy-makers. It may be useful to determine the motives for voluntary pension disclosure, and how these motives were affected by regulation.

FOOTNOTES

1Kirk, p. 1.
2Latimer, p. 21.
3AICPA (1966).
6Winslow, p. 9.
7Conant, p. 80.
8Conant, p. 89.
10Rosenbloom and Hallman, p. 287.
11Conant, pp. 50-51.
12Conant, p. 4.
13Conant, p. 45.
14Latimer, Vol. 1, p. 44.
15Kast and Rosenzweig, pp. 56-57.
16Conant, p. 40.
17Conant, p. 2.
20de Roode, p. 287.
21Conant, p. 54.
22Brandeis, pp. 67-69.
23Rand, p. 501.
24Hattfield, p.194.
25Hattfield, p. 194.
26Hattfield, p. 194.
28Whitmore (April 1929), p. 244.
30Kimball, p. 166.
BIBLIOGRAPHY


EARLY CANADIAN FINANCIAL STATEMENT
DISCLOSURE LEGISLATION

Abstract: The Ontario Companies Act of 1907 was one of the earliest legislative enactments to require presentation at company annual meetings, and specify the content of, the financial statements of commercial and manufacturing companies. The study describes the background to this important event and points to the two main influencing forces—the office of the Provincial Secretary and the equally active and informed Institute of Chartered Accountants of Ontario. The concern for disclosure suggests that Ontario was in the forefront of accounting development in the latter part of the nineteenth and the first decade of the twentieth centuries.

The turn-of-the-century financial statement requirements of the Canadian Province of Ontario constitute one of the earliest pieces of legislation in English-speaking countries to mandate shareholder disclosure of income statement and minimum balance sheet information for general commercial and manufacturing corporations. The background to this legislation exposes the complex and intermingled influences underlying this important event. Such influences as existing disclosure in regulated industries, an active and progressive-minded office of the Provincial Secretary in charge of Companies Act legislation, a political and economic environment that developed a tradition for government intervention and for federal-provincial jurisdictional disputes in commercial and industrial activities, an awareness and concern for recommended accounting changes in other countries, and a remarkably active and well-informed provincial association of accountants, the Institute of Chartered Accountants of Ontario (ICAO), all figured prominently in establishing the legislation.

The author appreciates the helpful comments of his colleagues, Professors V. B. Irvine, W. D. Lindsay, and T. Musser; the use of the libraries of the Ontario Archives, the Institute of Chartered Accountants of Ontario, and the Ontario Legislature; and the financial assistance of a Leave Fellowship Award from the Social Science and Humanities Research Council of Canada.
This study attempts to describe and assess influences which brought about this financial statement legislation. The evidence derives mainly from bills and statutes of provincial and federal jurisdictions, minutes of the ICAO, files of the office of the Provincial Secretary and corporate financial statements of the first decade of the twentieth century. The sequence of discussion relates to the legislation in question, the political and economic environment in Ontario that supported such legislation, the prominence of the ICAO, the activities of the office of the Provincial Secretary, the influence of the legislation including its impact on corporate financial statement reporting practices and lastly, some concluding comments.

*Early Ontario Companies Acts Legislation*

The Ontario Companies Act of 1907 is likely the most path-breaking piece of corporate disclosure legislation in Canadian history.¹ According to its chief architect, Assistant Provincial Secretary Thomas Mulvey, the Act attempted to prevent stock promotional abuse, to consolidate the legislation relating to numerous commercial enterprises which had previously commanded individual legislation, and to incorporate some of the regulatory features of the optional First Schedule requirements of the English Companies Act of 1862.² Of particular importance were the compulsory requirements to file a prospectus, to engage an auditor, and to provide an income and expenditure statement and a detailed balance sheet to shareholders at the annual meeting.³ The sections of the 1907 Act containing financial statement requirements for annual meetings are reproduced in Figure 1.

The requirement to present an income and expenditure statement at the annual general meeting was carried forward from the legislation of 1897.⁴

*The Political and Economic Environment in Ontario*

Though Canada, and particularly Ontario, inherited many of the traditions of Britain, the size, proximity, and power of the United States presented examples to be followed. In Canada, size, regionality, and ethnic differences (Quebec) pointed towards the adoption of a federal system of government as opposed to the unitary system of Britain. The provinces had powers relating to local concerns such as property, civil rights, civil law, education, provincial company charters, municipal government and direct taxation. The
Figure 1

Financial Statement Disclosure Requirements of the Ontario Companies Act, 1907. Selections from Section 36.

36 (2) At such meeting the directors shall lay before the company,

(a) A balance sheet made up to a date not more than three months before such annual meeting;
(b) A statement of income and expenditure for the financial period ending upon the date of such balance sheet;
(c) The report of the auditor or auditors;
(d) Such further information respecting the company's financial position as the Letters Patent or the by-laws of the company may require;

and, on resolution affirmed by shareholders holding at least five per centum of the capital of the company, shall furnish a copy thereof to every shareholder personally present at such meeting and demanding the same.

36 (3) The balance sheet shall be drawn up so as to distinguish at least the following classes of assets and liabilities, namely:

(a) Cash;
(b) Debts owing to the company from its customers;
(c) Debts owing to the company from its directors, officers and shareholders;
(d) Stock in trade;
(e) Expenditures made on account of future business;
(f) Land, buildings and plant;
(g) Goodwill, franchises, patents and copyrights, trademarks, leases, contracts and licenses;
(h) Debts owing by the company secured by mortgage or other lien upon the property of the company;
(i) Debts owing by the company but not secured;
*(k) Amount received on common shares;
(l) Amount received on preferred shares;
(m) Indirect and contingent liabilities.

*No entry for (j) is given in the Act.
federal government retained control over foreign affairs, trade and commerce, currency, criminal law, indirect taxation, postal services, federal company charters, banking, railways, and navigation, as well as residual authority in matters not specifically allocated to the provinces. Mulvey acknowledged, in explanation of the background to the 1907 Act, that though “the courts were always under the influence of the English decisions . . . , Legislatures obtained their inspiration from the United States”—especially with regard to the chartering of companies by letters patent as opposed to the English method of registration and memoranda of association.\(^5\)

The assignment of authority was such as to give rise to federal-provincial jurisdictional disputes, particularly, for our purposes, in matters relating to the chartering of companies and professional societies. The jurisdiction in which companies incorporated was of great concern to politicians and legislators, who were mindful lest they drive away corporate control from their domains.\(^6\) Ontario’s progressive interest in corporate regulation was constantly tempered by the considerable lag in time of comparable federal legislation.\(^7\) Though incorporation fees for the Ontario and federal jurisdictions were kept competitively comparable,\(^8\) government-required filing of Annual Returns (available to the public) relating to shareholders and directors, and their past and present addresses, callings and shareholdings, were initially much more onerous in Ontario.\(^9\) By 1900 the Extra Provincial Corporation Act of Ontario required federally incorporated companies to comply with the Annual Return filing of the Ontario Companies Act.\(^10\)

Similarly, in the 1907 Act, Ontario attempted to make its mandatory prospectus provisions apply to all companies doing business in Ontario, whether incorporated there or not.\(^11\) Some companies with purely local interests engaged in the “charter ploy” which meant that they would try to incorporate federally and avoid the harassment of uncooperative provincial legislatures.\(^12\) Federal-provincial disputes over incorporation remained matters of continuing conflict in the first two decades of the century.\(^13\)

Incorporation disputes spilled over into the accounting profession. Provincial incorporation of the ICAO in 1883 had granted what was felt to be exclusive right to the designation “Chartered Accountant.”\(^14\) However, members of the Dominion Association of Chartered Accountants (DACA), which had been federally incorporated in 1902,\(^15\) began to use the same name. The cause of the ICAO was taken up by the Ontario legislature, ever willing to support provincial claims; but intended provincial legislation was
"disallowed" by the federal powers. It was not until 1909, after much legislative and professional jurisdictional wrangling, that membership in the DACA was restricted to, and became automatic for, members of provincial institutes of chartered accountants. An additional irritant to the Province of Ontario and the ICAO, during this period was the claim by English chartered accountants that colonial legislation (in regard to designation) could not apply to their members practising in Canada.

The political and economic environment in Ontario prior to and at the turn of the century was both supportive of business and mindful of the social obligations that business must accept. The Ontario government has been characterized as one in which "the language of business, the methods of business, the concerns of business for economy and expertise were reflected in [its] policies. . . ." This spirit coexisted with a host of mandatory public financial statement disclosure requirements for such regulated enterprises of public interest as utilities, municipalities, railroads, savings and loan associations and insurance companies. In the latter part of this period, the Conservative government under the leadership of J. P. Whitney, and in the American "progressive" tradition, "reflected a recognition of the rise in the province of an urban industrial society"—a society in which government intervention and direction were to be expected. The Companies Act of 1907 was accompanied by equally path-breaking legislation relating to mining, workmen's compensation, health and education, and most notably the formation of the controversial government-owned Hydro Electric Power Commission of Ontario. Business was scarcely in a position effectively to object to such intervention since as Bliss comments

... for generations the Canadian Manufacturers' Association existed primarily to lobby for continued or increased tariff protection. No organization in Canada was so deeply opposed to free enterprise in business than the CMA. Because of its effectiveness in championing state intervention and in demonstrating to other groups how to follow its lead, the CMA did more than any other organization to encourage the development of collectivism in Canada. It was socialism's best friend in Canadian business.

The amount of public disclosure of financial statements in the late nineteenth and early twentieth centuries was certainly considerable. That disclosure pertained not only to those companies that were by statute required to publish, but also to those com-
panies of a commercial or manufacturing nature that were not. Despite concerns over revelations of reporting ambiguities issuing from the Royal Commission on Insurance, the Financial Post in 1907 was able to pronounce that "nearly all the most important companies have adopted a straight-forward policy of publicity of earnings and condition." Following, in many instances, counterpart legislation in England, the interventionist hand of government had mandated certain public disclosure of the financial affairs of those companies deemed to be of general public or fiduciary interest. In Ontario by 1877, the operating returns of companies incorporated under the General Road Companies Act were required to be forwarded to the Municipal County Council. Similar provisions required timber hauling companies to forward returns to the Commissioner of Public Works. Gas- and waterwork companies were required to publish operating information and to have a statement of debts and liabilities available for inspection by shareholders and creditors. Municipal institutions were required to appoint auditors, to have an abstract of receipts, expenses, assets, and liabilities open for inspection and published, and to file "a true account of all debts and liabilities to the Treasurer of Ontario" if there were outstanding loans. Building societies were required to provide a "full and clear" statement of assets and liabilities to the Provincial Treasurer —abstracts of which were to be published by the latter. Railways were required to forward "a true, exact and particular account of the money collected and received" to the Provincial Secretary and insurance companies were required to provide a balance sheet and income statement in prescribed detail to the Provincial Treasurer. Earlier, in 1873, mutual fire insurance companies were required to forward, under prescribed categories, detailed balance sheets and income statements to the Provincial Secretary and Registrar, a synopsis of which was to be published in the Ontario Gazette. In 1892, insurance companies were required to have auditors and by 1896 street railway and electric railway companies were obliged to forward detailed financial statements to the Provincial Secretary. Comparable counterpart legislation existed at the federal level for banks, insurance and railway companies. General practice among such regulated companies well before the turn of the century, was to publish or to have represented, their financial statements in such publications as The Monetary Times and The Globe. By the turn of the century, prospectuses were commonly published in such media and easy access to the affairs of many of the nonregulated commercial and manufacturing enter-
prizes representing the bulk of such listings on the Toronto Stock Exchange was obtainable through annual anthologies of financial statements. The publication of these anthologies was undertaken very likely with the support and sponsorship of the Toronto Stock Exchange, though early Exchange listing regulations of 1905 and 1912 required that "a full statement of the affairs of the company" be provided only at the time of the listing application. Quite clearly a strong tradition for financial statement disclosure was in existence at the time of the 1907 Ontario Act.

The Institute of Chartered Accountants of Ontario (ICAO)

The fact that the financial statement requirements of the 1907 Act were virtually written by the ICAO is not surprising in light of that organization's tradition of spirited and informed membership. First organized in 1879, the Institute's subsequent incorporating legislation of 1883 granted it a charter "as an intellectual and educational movement to raise the standard of accountancy" and required "the promotion . . . of knowledge, skill and proficiency of members of the Institute . . . and to these ends the establishment of classes, lectures and examinations and the prescription of such tests of competency, fitness and moral character. . . ." It is likely that the Institute's remarkable vigor, prominence and authority were engendered by the organizational activity necessary to fulfill that educational mandate. Within ten to fifteen years of inception, the Institute had established a tradition for regular meetings during the year, to which the public was invited and at which papers relating to accounting matters were delivered. In commenting on this tradition, the President of the ICAO acknowledged the importance of keeping the Institute before the eyes of the public and raising the standards of the profession. Regulations were devised categorizing the various divisions of competency that were recognized, and periodic examinations were set to determine that competency. The highest level, "Fellowship," required a thesis to be prepared—the presentation of which became a tradition at one of the regular meetings. By 1893, virtually all founding members had submitted to qualification of competency by examination. The notice for the sitting of exams, questions and answers to exams, the proceedings of the annual meetings and the accounting papers delivered at regular meetings were commonly reported on, often at great length, in the financial press. As early as 1893, the Institute sought out and accredited various colleges and schools that were able to provide sufficient accounting education to stu-
dents to qualify for the introductory level of competency.\textsuperscript{49} Yearbook publication began in 1896. Papers delivered at meetings were being published in professional journals;\textsuperscript{50} reprints of the papers were frequently distributed among Ontario businessmen; and several attempts to begin a regular journal were discussed.\textsuperscript{51} Efforts to establish a formal Institute library were finally successful in 1903.\textsuperscript{52} Prior to that time, Institute committees regularly urged the Toronto Public Library to carry a wide range of accounting related books. The influence and concerns of the ICAO extended throughout Canada as it sought to initiate uniform examinations and standards for emerging Chartered Accountants Institutes in Manitoba and Nova Scotia.\textsuperscript{53} A student society formed by the Institute\textsuperscript{54} intensified the concern for lectures and the publication\textsuperscript{55} of textbooks and examinations. An impressive list of texts authored by Institute members developed including

- \textit{Municipal Accounting} by F. H. Macpherson (exact dating not established).
- \textit{Manual for Accountants} by W. C. Eddis, 1899.
- \textit{Primary Accounting Manual} by D. Hoskins (exact dating not established).
- \textit{Expert Bookkeeping} by C. A. Fleming, 1892.
- \textit{Bookkeeping for Joint Stock Companies} by D. Hoskins, 1901.

The Eddis and Tindall text has been singled out by Garner as being influential on American practice by dismissing "as being entirely inadequate the nonintegrated cost systems which had been advocated so strenuously by the English."\textsuperscript{56} It is noteworthy that all of these authors except Fleming either attended, or sent letters to, the meeting at which the Institute presented its financial statement recommendations for the Ontario legislation. Quite clearly, Institute membership was sufficiently interested and independently well-informed to be able to advise provincial legislators on matters of financial statement disclosure. No reference
exists in the minutes indicating knowledge or influence of the optional model financial statements of the 1862 English Companies Act.

The Institute's relations with the government were highly visible from the beginning. President Harmon, under whom incorporation was sought in 1883, was a former mayor and treasurer of the city of Toronto. Vice president Mason held similar offices in Hamilton and was related by marriage to J. M. Gibson, a subsequent Provincial Secretary and Lieutenant Governor of Ontario. The large public meeting of the Institute which preceded the petition for incorporation was held in the offices of the city of Toronto. The interaction with government was not only of a self-serving nature in which the Institute, usually unsuccessfully, sought a monopoly for its services in particular areas of legislative concern, but also of a broader professional nature. Recommendations were forwarded to the Provincial Secretary relating to municipal accounting in 1888, to the federal Finance Minister relating to the duties, certificate, and qualifications of bank auditors in 1890, and to the Secretary of State relating to the Dominion Companies Act of 1902. A Legislative committee of the Institute Council was formed in 1895. Deputations to the Provincial Cabinet with regard to qualifications of auditors doing municipal work successfully obtained mention in the legislation of institute members' qualifications. Meetings at the federal level with the Minister of Finance in 1897 were concerned with the formation of an inter-provincial Dominion accounting association and with uniformity in the handling of bankruptcies. Institute standards (through their qualifying examinations) were recommended for all public accountants by the financial press. In the face of the federal government's incorporation of the Dominion Association of Chartered Accountants, the provincial government's jurisdictional concerns were also served as it responded positively to the Institute's lobby to restrict the C.A. (chartered accountant) designation to members of the ICAO. The appointment of an American auditor to perform some investigatory work for the Provincial government invited an enormous amount of Institute-organized resistance and embarrassing publicity for the Government in the press.

The first draft bill leading to the 1907 legislation included the ICAO recommendations which had been made almost a year previous at the specific request of the Provincial Secretary. The latter, together with his Assistant, attended a special Institute meeting to hear members' comments on the legislation. The Provincial Secretary, his Assistant and the former Provincial Secretary
were all awarded honorary Fellowships in the Institute, as was the editor of Canada's leading financial newspaper *The Monetary Times*.

The chief source of strength in the ICAO at the turn of the century was certainly Canadian in its origin. The guiding spirit in the Institute at this time was George Edwards, whose father was an Ontario government civil servant. The Institute was always mindful of the somewhat more lengthy traditions of public accounting in England and of the English legislation relating to matters of accounting and auditing, but the Institute minutes betray little "mother-country" influence beyond that. English Chartered Accountants could become members of the ICAO upon application (a privilege that was reciprocated!) but they came to Canada as individuals, not as members of English accounting firms who would set up international branches. The split between native and English influence that Merino indicates existed in America up to 1905, seemed to have no counterpart in the ICAO's history.

In America, the Report of the Industrial Commission had held back from recommending mandatory company audits because of a concern for the ability of the public accounting profession to respond. No such reservations were entertained in the considerations leading up to the mandatory audit provisions of the 1907 Ontario Act. Nor were Institute members unassuming in their feelings of prominence. In 1902, the President proclaimed the ICAO as being "the leading and recognized head of the accounting profession on the continent." In 1907, after returning from meetings of the American Association of Public Accountants, the President with similar modesty stated at the annual general meeting that he was "pleased to report in point of excellence of work and results the Ontario Institute is certainly far in advance of any of the State Associations." Edwards proclaimed, in *The Monetary Times*, that the Ontario Institute's standards . . . were higher than those of any other in Canada or the United States. It may be observed that from 1894 to 1910, Institute membership grew from 78 to 130.

**Background to the 1907 Act and the Efforts of the Office of the Provincial Secretary**

Prior to the 1907 legislation in Ontario, the public's legal right to information about the financial affairs of commercial and manufacturing companies was limited to access to the company Annual Returns that were required to be filed with the Provincial Secretary and which contained summary information about the capital
stock and detailed information concerning the names, addresses, occupation, and shareholdings of each shareholder and director. The books of the company filing such information were also open for the inspection of creditors and shareholders. Court-approved inspections and optional audit requirements accompanied these provisions, together with the requirement for directors to present an income and expenditure statement at the annual general meeting. The foregoing procedures were embodied in the 1897 Ontario Companies Act. By 1907 however, the legislative emphasis had shifted markedly from providing information about the capital stock, directors, and shareholders, to furnishing investors with a prospectus, and shareholders with audited, detailed information about the results of the directors’ handling of the company’s operations. An investor point of view inspired much of the legislation. The creation of “private companies” was the device which legislators used to allow small, closely-held corporations to avoid filing a prospectus.

The office of the Provincial Secretary was an active source of proposals for legislative control over corporations. The 1897 Ontario Companies Act was preceded by an intensive investigation of the corporate legislation of other countries and of several American States. The office was therefore aware of the extremely progressive draft legislation of the state of Victoria in Australia and of the English Davey Committee Report. The first reading of the Bill preliminary to the 1897 legislation contained the mandatory provisions for audit and detailed financial statements to shareholders in the optional form prescribed by Table A of the First Schedule of the 1862 English Companies Act (Figure 2 shows the form of Balance Sheet); however concern lest such provisions prove too onerous for small companies prompted withdrawal of these provisions. Only the requirement to supply an income and expenditure statement to the annual meeting remained in the Act.

An employee of the office of the Provincial Secretary, J. D. Warde, was the author through at least seven editions (1884-1907) of The Shareholders’ and Directors’ Manual. This text, dedicated to the Provincial Secretary and acknowledging the helpful reviews of the Assistant Provincial Secretary, Thomas Mulvey, and one of the most prominent ICAO members, George Edwards, recommended full disclosure in matters of financial statement presentation and put forward as a model of disclosure the balance sheet prescribed by Table A. Legislators’ comments at the federal level in support of an unsuccessful 1894 Companies Bill incorporating broad disclosure provisions argued for the public right to greater
Figure 2

Balance Sheet Optional Requirements of Table A of the First Schedule of the English Companies Act of 1862.

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knowledge of the financial affairs of large commercial and manu-
facturing endeavors.  

The appointment of T. Mulvey as Assistant Provincial Secretary in 1904 was followed by the election of J. P. Whitney's Conservative government and appointment of W. J. Hanna as Provincial Secretary. Hanna, a prominent businessman, and particularly Mulvey, the scholarly and progressive minded civil servant, were the moving forces behind the 1907 Act. Under their directions, draft legislation was circulated to many interested parties in 1906 and 1907, and many hearings and much correspondence with the office of the Provincial Secretary preceded enactment in 1907. Possibly because of the carefully orchestrated, widespread discussion of the legis-
lation, the bulk of the evidence in the files of the Provincial Secre-
tary in the Ontario Archives is generally supportive.

The moving spirit behind the legislation was largely Mulvey, whose concern for greater information for the investing public oftentimes ran counter to the prevailing business sentiments for corporate secrecy at a time when the promotion of stock without prospectus information was not uncommon. Mulvey was particularly concerned with stock promotion abuses and his main attention and enthusiasm in the legislation centered on the mandatory pro-
spectus requirements and on the stock allotment provisions that would inhibit the prevalent practice of stock watering. The bulk of the correspondence in the Provincial Secretary's files was similarly directed. The financial statement disclosure requirements, while fitting in with Mulvey's general theme for the provision of increased information, were not the thrust of the legislation and it may well be that these annual reporting requirements (because of their complementary nature) rode along on the coattails of the provisions directed at stock promotion abuse.

With regard to mandatory prospectuses, Mulvey stated "we have no desire to drive people away from incorporating under our Act, but it is far better to let scalliwags go elsewhere than to allow them to do as they please under the Ontario laws." Though a marginal note on an internal copy of draft legislation in the files of the Provincial Secretary indicated that some American States had equivalent financial statement disclosure requirements, no specific references to such legislation were otherwise available nor could any other reference to American influence be found in the files of the Provincial Secretary, in the voluminous public writings of Mulvey or in the financial press. (Horack, Kuhn, and Sterrett all emphasize the ineffectiveness of whatever little American annual reporting requirements were then extant.) The legislative
mould was the Companies Acts of England, but Mulvey improved on them most notably by ensuring that companies could not avoid the prospectus provisions and by requiring an income and expenditure statement and a detailed balance sheet. For the financial statement disclosure requirements, he accepted without change the recommendations of the ICAO. The Act itself was consistent with the legislative pattern of the progressive-minded Whitney government.

The Impact of the Legislation

Some tentative comments are possible with regard to the effect on corporate reporting practices of this legislation in 1907. The Annual Financial Review—Canadian requested corporations to forward information on their financial affairs for publication in its annual anthology. The vast majority of those commercial and manufacturing companies whose stocks were listed on the Toronto Stock Exchange forwarded their financial statements and/or information from the Annual Returns required by the Provincial Secretary or the federal Secretary of State. Of companies in the anthology incorporated in Ontario, only one of five in 1905 did not provide financial statements and by 1910 all twenty-one were doing so. Of federal or other-province companies, where mandatory provision of financial statements to shareholders did not exist, nine of seventeen did not provide financial statements in 1905 and by 1910, only seven of thirty-four were not doing so. A subjective review by the author of the amount of information disclosed in the commercial and manufacturing financial statements indicated only a marginal improvement in 1910 statements over those of 1905. In both years these statements, while in some instances aggregating accounts that were required to be distinguished, usually contained more information than the 1907 legislation required.

The legislation—though little concern is apparent in the files of the Provincial Secretary!—also covered mining companies. Evidence with regard to the impact on disclosure of these financial statements is more forceful in demonstrating the impact of the legislation. In 1906 immediately prior to the 1907 legislation, seventeen of twenty-eight companies listed in the Annual Financial Review—Canadian did not disclose their financial statements; in 1908 all but four of thirty-five disclosed. Related provincial mining company legislation is somewhat perplexing. The Supplementary Revenue Act of 1907 required that mining companies pay a 3% tax on income in excess of $10,000. However neither this statute nor the later consolidation statute of 1914, though they pain-
stakingly set forth the expenses which were to be regarded as valid deductions in arriving at taxable income, made any reference to the required minimum and audited format of the 1907 companies act legislation—format which it would seem would have been complementary to the purposes of the revenue act.

The number of firms voluntarily disclosing at the provincial level prior to 1907 and at the federal level prior to 1910 was considerable. The example of mandatory disclosure of regulated corporations (England had much the same required disclosure for regulated firms), the concern for financing from the investing public, the likely encouragement of the Toronto Stock Exchange and the moral suasion certainly of the office of the Provincial Secretary and possibly of some of the members of the ICAO may in varying degrees have been influential. No provisions existed at the federal or provincial level for the imposition of income taxes prior to 1907. The infrequent requirement to pay income taxes at the municipal level prior to 1907 likely did not occasion the filing of financial statements which would have been available to the public.

The response in the financial press to the financial statement provisions of the 1907 legislation was not unexpectedly silent, since the legislation had been openly discussed for the previous one and one-half years. The legislation was not attributed to any grand corporate scandals proceeding from financial statement inadequacies; and the tradition for legislated mandatory disclosure in the many regulated areas of enterprise together with voluntary disclosure by nonregulated companies, may have made the absence of such legislation for commercial and manufacturing firms appear anachronistic.

The Ontario legislation served as a model for other provinces. The federal government itself in 1917 enacted identical disclosure legislation and acknowledged its debt to Ontario in this regard. In 1909 Mulvey became the Under Secretary of State of the federal government and once again (possibly with support from George Edwards, who had been brought to Ottawa by the federal government during World War I) was the initiating spirit in the office of the Secretary of State for this legislation at that level. In the first two decades of the century, governments and bureaucracies were sufficiently small or nonlabyrinthine that the strong leadership of an individual could make a difference.

Concluding Comments

The 1907 Ontario legislation is significant in the evolution of corporate disclosure because it is one of the earliest statutes in
the English-speaking world to make detailed financial statements mandatory for commercial and manufacturing companies, and also because it is one of the earliest occasions on which an accounting organization has demonstrated its influence on disclosure legislation. The varied and complementary circumstances under which these financial statement provisions took place are instructive.

Prior to the legislation, voluntary disclosure of such information for these companies had been regarded as uniformly good. Similarly, there existed a long-standing legislative tradition for required disclosure among those regulated enterprises having a public or fiduciary interest. The general demand for change was therefore directed towards the various needs which a mandatory prospectus would satisfy. Required financial statement disclosure rode along on the coattails of the rationalizing of numerous incorporating statutes, of the concern for stock promotional abuse and of the general movement to greater societal control of corporate operations. It was the concern for the investing public that particularly informed the mind of the chief government proponent of the legislation, Thomas Mulvey. The Act, in total, was consistent with the reforming spirit of the Whitney government.

Though Mulvey copied much of the prospectus legislation from England, for financial statement disclosure purposes he bypassed the recommendations of the Davey Committee and the provisions of the English Companies Act of 1900 and sought out the aid of the well regarded and highly visible ICAO. The Institute, with its lengthy record of competence engendered by a mandated, onerous, and well publicized involvement in education, was sufficiently confident in its own abilities to propose disclosure unique to legislation at that time. The record of achievement of the ICAO for the period from 1880 to the legislation of 1907 invites comparison with other accounting institutes for those years.

FOOTNOTES

1Ontario, Statutes, (1907).
2Mulvey, (1907), pp. 81-82; and Ontario Archives, correspondence of T. Mulvey with G. Staunton, February 20, 1907.
3Ontario, Statutes, (1907), Secs. 97, 123 and 36 respectively. The mandatory audit provisions followed the English Act of 1900, but the Ontario requirements for an income statement and a detailed balance sheet predated English concern by a full three and two decades respectively.
4Ontario, Statutes, (1897), Sec. 75.
5Mulvey, (1918), p. 129.
6Ontario Archives, correspondence of T. Mulvey with G. Staunton, February 20, 1907.
Federal legislation equivalent to the Ontario Act of 1907 followed only a full decade later in 1917. 

Ontario Statutes, (1900), Sec. 12.

Ontario Statutes, (1907), Sec. 95(2).


Ontario Statutes, (1883), Sec. 2.

Canada Statutes, (1902).

Ontario, Statutes, (1900), Sec. 12.

Ontario, Statutes, (1907), Sec. 95(2).


Ontario Statutes, (1883), Sec. 2.

Canada Statutes, (1902).

ICAO, Minutes, (February 15, 1902, July 19, 1907, Dec. 27, 1907, and Minutes of Annual General Meeting July 18, 1908).


See references to statutes following.


Canada, Royal Commission on Life Insurance, (1907).


Ontario Statutes, (1877), ch. 152, sec. 146.

Ontario Statutes, (1877), ch. 153, sec. 27.

Ontario Statutes, (1877), ch. 157, secs. 22, 32 and 33.

Ontario Statutes, (1877), ch. 174, secs. 254-257 and 363.

Ontario Statutes, (1877), ch. 164, secs. 67-68.

Ontario Statutes, (1877), ch. 155, secs. 26, 36.

Ontario Statutes, (1877), ch. 160, secs. 26-27 and Schedule B.

Ontario Statutes, (1873), ch. 44, sec. 72.

Ontario Statutes, (1892), ch. 39, sec. 29.

Ontario Statutes, (1896), ch. 50, sec. 16.

Ontario Statutes, (1895), ch. 38, Schedule C.

Canada Statutes, (1886), ch. 120, secs. 24, 66 and Schedule B.

Canada Statutes, (1886), ch. 45, sec. 19 and Form A.

Canada Statutes, (1888), ch. 29, sec. 299 and Schedule One.

See for example The Monetary Times (January 11, 1901), pp. 898-900 and (February 22, 1901), p. 1108.

See various issues of The Annual Financial Review—Canadian from 1901 to 1941.

Toronto Stock Exchange Bylaws, Rule 26 of 1905 and 1912. A long time employee of the Exchange, L. Lowe confirmed in conversation with the author the close and complementary relationship between the Exchange and the publisher W. R. Houston and supported the implication that the Exchange had no specific regulation with regard to the disclosure of annual financial statements at the turn of the century. Houston maintained his offices with one of the member firms of the Exchange and subsequently in the Exchange building itself; for much of the 1920s and 1930s, he was the Assistant Secretary of the Exchange.

ICAO, Minutes, Figure 1 is almost identical with the recommendations of February 8, 1906.

ICAO, Minutes, (November 11, 1879).

Statutes, Ontario, (1883), Preamble and Sec. 2.

ICAO, Minutes (1885-1900). See also Edwards (1909), pp. 1984 and 2038.
ICA0, Minutes, (July 19, 1901).

ICA0, Minutes, April 1894. (Exact date not given.)


For example ICA0, Minutes (March 22, 1881; November 4, 1885; November 25, 1886; April 19, 1888).

ICA0, Minutes, March 20, 1893 and February 28, 1895. By 1895 affiliation was established with Northern Business College, Upper Canada College and The Ontario Business College.

See four articles by ICA0 members A. C. Neff, W. T. Kernahan, and W. C. Eddis in January, February and March issues, 1899, of Accountics.

ICA0, Minutes (October 6, 1885, March 21, 1889, June 20, 1893, November 23, 1906, July 19, 1907). Concern expressed for publishing “Questions and Answers” to Institute exams (March 26, 1891).

ICA0, Minutes (October 22, 1885, February 21, 1893, July 17, 1903).

ICA0, Minutes (July 15, 1904).

ICA0, Minutes (January 4, 1900).

ICA0, Minutes (October 4, 1893).


ICA0, Minutes (April 19, 1888).

ICA0, Minutes (March 21, 1890).

Ontario, Archives RG8 1-1-D, File 3240.

ICA0, Minutes (April 9, 1897).

ICA0, Minutes (March 19, 1897).

The Monetary Times (Sept. 14, 1900), p. 841.

Ontario, Statutes (1908), Sec. 13. This Act was disallowed at the federal level.

ICA0, Minutes (April 14, 1905).

ICA0, Minutes (February 8, 1906), and Ontario, Bill 101, Sec. 35.

ICA0, Minutes (January 18, 1907).


ICA0, Minutes (July 18, 1902).

ICA0, Minutes (July 19, 1907).


Ontario, Archives, RG8 1-1-D, Files 1822, 3640-49.

The Victoria legislation was revised in 1910 to bring it into conformity with English law, Gibson (1979), p. 33. Corporate legislation of the province of British Columbia in 1904 mandated a detailed income and expenditure statement and the balance sheet detail of Table A of the First Schedule of the English Companies Act of 1862, but rescinded these requirements in 1910 to conform to the disclosure requirements of the English Companies Act of 1900.

Ontario, Bill 74, Secs. 60-61.

Ontario, Archives, RG8 1-1-D. An internal memo of January 30, 1902 from G. E. Lumsden, the Assistant Provincial Secretary to J. R. Stratton, the Provincial Secretary, indicated that these provisions would “work a hardship” on small or close corporations.

Warde (1900), pp. iii-vi, 262, 339.

Canada, Senate Debates (June 13, 1894), pp. 523-524.

Note that the first draft bill to amend the Companies Act in 1905 pertained only to the prospectus provisions. This Bill was deferred and later incorporated in the 1907 legislation. Ontario, Bill 100 (1905).

Ontario, Archives, RG 8 1-1-D. Letter of Mulvey to G. L. Staunton, February 20, 1907.
Murphy: Early Canadian Financial Statement Disclosure Legislation

80Ontario, Archives, RG8 1-1-B-1, Box 3.
81Horack (1903), pp. 83-86.
82Kuhn (1912), pp. 144-146.
84Checked for the years 1900 (11 of 13) and 1905 (17 of 19) to the Exchange listings in The Monetary Times and for 1911 (75 of 77) to The Globe.
85Ontario, Statutes (1907), Sec. 6.
86Recent interest in voluntary disclosure provides interesting hypotheses. See Mumford (1982), Watts and Zimmerman (1979), Morris (1979) and Ma and Morris (1981).
87An enquiry of the City of Toronto Archives provided correspondence (July 12, 1982) which indicates that in 1905 and 1906 the only taxes exacted by the municipality of Toronto were personal.
88Canada, Statutes (1917), Sec. 105, and Mulvey (1920), p. 54.
89Mulvey as the then federal Under Secretary of State, spoke to legislation at the hearings of the Senate Standing Committee on Banking and Finance, July-August, 1917.

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Ontario. Statutes. The Ontario Companies Act, 1897. 60 Vict., ch. 28.
Ontario. Statutes. The Supplementary Revenue Act, 1907. 7 Edw., ch. 9.
Ontario. Statutes. The Ontario Companies Act, 1907. 7 Edward VII, ch. 34.
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The Globe. Toronto.
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CYCLICAL ASPECTS OF TWENTIETH CENTURY AMERICAN ACCOUNTING

Abstract: A model of change in twentieth century American accounting is presented. The model describes three-phase cycles, each consisting of a reactive, a proactive, and synthesis phase. The text and Appendix illustrate and attempt to validate the model, and to make projections for the future.

The development of accounting in twentieth century America, as well as of accounting generally, has been chronicled in several excellent texts, some listed in the attached Bibliography, notably: A History of Accounting Thought; Management Accounting: An Historical Perspective; and A History of Accounting in America. These texts utilize a chronological approach, and the intent of this article is to restate these chronologies in a framework which interprets them as a cyclical pattern. A model is proposed that divides a cycle of events into three phases. Each cycle is initiated by a reactive phase, progresses through a proactive phase, and terminates with a synthesis phase.

The term "reactive" describes the response of the accounting profession to strong, external, environmental forces at the beginning of each cycle. These environmental forces may be political, financial, managerial, social, technological, or cultural. They call for a response from the profession, which takes various institutional actions, issues regulations and rulings, and resolves conflicts. At this stage, responses are reactions to pressure rather than coherent, structured formulations.

"Proactive" describes the processes and procedures occurring within the accounting profession itself to bring order to the resulting chaos. The proactive agents—professional accounting societies, state licensing boards, educators, individual practitioners, and even college/university accreditation agencies—pose questions, seek answers, compromise, and finally innovate to systematically change accounting. The resulting decisions, procedures, guidelines, etc. are the synthesis, which develops into the beginning
phase of a new cycle as government and business force further innovative responses from accountants. The new responses generate their own problems and the shift to the proactive phase recurs.

To illustrate the model, the article discusses twentieth century American accounting in three ways. The Appendix charts the reactive-proactive-synthesis phases of selected accounting topics. The text describes each cycle and its phases. Finally, implications for future directions of American accounting are projected.

**Cycle 1: 1900-1939**

The first decade of the twentieth century provided the American accounting profession with two powerful masters: industry, with its preference for nondisclosure; and financiers—mostly banks. Four reasons have been suggested for management secretiveness: a belief that the public had no right to information; a lack of any tradition of disclosure in the small, family owned predecessors of large industrial organizations; fear that disclosure would assist competitors; and the doctrine "let the buyer beware." The accounting profession served the needs of this management class, and since most managements were very conservative, conservative accounting practices for fixed assets, inventory replacement, and dividend income were used by the accountants working for them. Conservatism, as used in accounting, means a method which tends to reduce the value of assets, and understate rather than overstate profits. However, management of another industry, corporation, or division of the same company might choose more liberal accounting methods. Bankers, of course, favored conservatism since it made loan repayment more likely and reduced the possibility of inflation.

During the first decade, two contrasting philosophies emerged variously labeled as the "Traditional American Creed" and "Progressivism." Social, economic, and legal theories emphasizing the rights of individuals and protecting ownership of tangible goods comprised the traditional American creed, whereas progressivism embraced the rights of the community, specifically stockholders, to information. The idea that government and corporate financial publicity served as a check against many public abuses was a progressivist creed. Business failures of the 1890s, resulting from stockwatering and overcapitalization, fueled the progressivists' position. In response to such abuses, the federal government established the Industrial Commission in 1898. Its preliminary report, issued in 1900, suggested that an independent public account-
The final report of the commission concluded that larger corporations should be required to publish annually a properly audited report so that the public and investors could not be deceived. Although these reforms were proposed, they were not enforced until the fourth decade of the century. This time lag occurred because business's role in World War I caused a resurgence of the traditional American creed until the 1929 stock market crash. However, progressivism encouraged the use of annual government budgets, adopted during the second decade.

The second decade of the twentieth century also saw the growth of municipal, state, and federal government, adding to the number of social pressure groups. Municipalities, most states, and the federal government through the National Budgeting and Accounting Act of 1921, tended to centralize government accounting. Initially, government accounting did not impact the business sector. However, the Sixteenth Amendment of the Constitution, passed in 1913, and the Excessive Profits Tax of 1917, forced accounting on business firms. "CPA's had the immediate problem of helping thousands of business men who had never felt the need to make financial statements, and who now got their first statistical view of their total operations." Naturally, business firms wanted accounting practices which would minimize payment of federal taxes, and these included asset-value write-ups that continued through the 1920s. Thus, during the third decade of the twentieth century, the growth of accounting practice included tax expertise, advising business, and preparing credit reports to bankers.

During this third decade, the Investment Bankers Association of America sought to standardize financial reporting in the securities field. Standardization, it was believed, would protect the Association and investors, and forestall government regulation. However, its suggestions were rarely followed, perhaps because members of the Association were indifferent, did not understand the recommendations, feared losing industrial clients, felt that their reputation in offering a stock was enough for potential buyers, or even protected dubious securities by nondisclosure.

During the first three decades of this cycle, accountants had little liability to third parties (investors). Courts maintained that since investors were not party (privy) to the contract between a firm and its auditor, they did not have the right to sue auditors (privity of contract). State (Blue Sky) laws also had little impact partly because most companies operated in more than one state, and also because states failed to fund enforcement of their investor...
protection laws. However, security holders continued to sue accountants for fraud, negligence, and/or breach of contract, to try and recover losses. By the end of the 1920s investors were successful in some audit liability cases, and third party liability increased in the 1930s.16

Thus, security holders, especially investors in securities quoted on the New York Stock Market and the Investment Bankers Association of America, provided the final pressure during this cycle. The New York Stock Exchange in 1922 required that all listed corporations file complete annual financial statements. Although resisted by some corporations and investment bankers, ninety percent of issuers listed were filing annually by 1926.17 However, these rules drove some corporations to over-the-counter dealers and provincial exchanges.18 These nonfiling firms were required to comply with annual reporting requirements in 1964.

A variety of accounting practices had developed to serve the needs of bankers, businesses, government, stock market investors, and others. Each group sought information for its needs while sometimes denying the information needs of other groups. At different times the American Institute of Accountants, the Investment Bankers Association of America, accounting educators, individual practitioners, investors, bankers, and some stock market authorities argued for stronger and more uniform accounting disclosure during the first three decades of the twentieth century. The financial crash of 1929 provided the occasion to switch from the reactive to the proactive phase of the cycle, and to heal rifts between user groups. In quick succession, the federal government and stock exchanges in association with accounting societies undertook the task of defining reporting and disclosure principles. Theory and practice research programs were initiated by accounting societies.19

Banks still favored conservative disclosure rules, based on corporate ability to repay credit. Industries now favored, and used, asset write-downs, while investors wanted to evaluate a company's value on the basis of current and predicted income. Accountants were caught between two factions, creditors and investors, in terms of the "fairness doctrine," a concept that financial disclosure be meaningful to all users of financial statements.20 To resolve this conflict, the New York Stock Exchange and the American Institute of Accountants met and developed compromises published in the 1934 Audits of Corporate Accounts.21 Financial statements were intended to emphasize income rather than assets and liabilities, generally accepted accounting principles were to be followed, and
independent public accountants were to annually audit and certify reports to stockholders.

The Securities and Exchange Act of 1934 gave the federal government power to enforce uniform accounting principles, as part of Roosevelt's "New Deal" to reestablish investor confidence. The investor was viewed as the primary user of financial information. Accountants sometimes joined with management to oppose government intervention, but they were sensitive to the charge of being a "tool" of management, and acknowledged that responsibility for decisions rested on management. Now to protect investors, conservatism via asset understatement, income smoothing, and write-downs of asset value became the compromise solution.

Thus, the synthesis phase of the first cycle produced the fairness doctrine, compromise via conservative disclosure rules, and audits by independent public accountants. These, especially the conservative disclosure rules, provided the seeds for the reactive phase of the next period.

**Cycle 2: 1940-1959**

The pressure groups during this second period were much the same as during the previous period; however, power shifts were evident. Investors were more militant and united in their demands for income disclosure. Accounting societies, notably The American Institute of Accountants, now the American Institute of Certified Public Accountants, and the American Accounting Association, had grown in numbers and gained power from working through the 1930s with the SEC. They had matured in their relationships with each other, with business and the public. The American Institute issued fifty-one Accounting Research Bulletins between 1939 and 1959. The Institute's APB Opinions and the SEC's Accounting Series Releases generally reinforced each other, especially in agreeing that financial statements should be designed for stockholders rather than banks. Later they would diverge over historical cost and inflation accounting. For example, some corporations tried to augment depreciation based on original cost with additional charges in order to reflect the impact of inflation. This was initially disallowed by the SEC, but the compromise of accelerated depreciation was accepted. Although LIFO inventory valuation was first permitted in 1938, it was not until the 1954 Revenue Act that LIFO became a major force in accounting, largely through its tax implications.

The most dramatic changes were the increase of federal spend-
ing and inflation. World War II had a tremendous impact on capital expenditures. Since winning the war, as opposed to expected return on investment, was the criterion for capital expenditures, few capital budgets were studied until the 1950s. Later, the emergence of fund accounting by government agencies, high defense spending resulting from the Cold War, and the switch to performance budgets by the Defense Department in 1949, had the accounting profession racing to catch up with new responses to government and business innovations.

The proactive part of the cycle was affected by public ignorance and mistrust of financial statements, fed by the multiplicity of generally accepted accounting principles. Reduction of alternatives seemed to be the logical solution. The accounting societies undertook this task. Basic issues were asset valuation, depreciation, inventory pricing and corporate consolidations. However, the cycle ended with an increase in acceptable reporting practices, resulting from compromises based on how widely a practice was used rather than merit. Innovations were the proliferation of practices rather than a re-evaluation of the underlying principles. The synthesis of this period, multiple accounting principles, causes confusion and difficulty in today's third cycle.

Cycle 3: 1960 to Present

The pressure groups of the second period remain, although power shifts are again evident. Inflation has gained prominence, and so has federal government spending. Conglomerate formation and dissolution require major accounting responses. New forces during this era are those involved in computer accounting and auditing, transnational corporations, franchise firms, consumer protection groups, government regulatory agencies, and self-regulation by the accounting profession itself.

The Program Planning Budget System, adopted by the Defense Department in 1961 and the entire federal government in 1968, requires projections into the future, while public accountants have restricted themselves to historical data. Federal laws and agencies currently involved in regulating accounting include the Employee Retirement Income Security Act (ERISA), the Securities and Exchange Commission (SEC), Federal Trade Commission (FTC), General Accounting Office (GAO), Occupational Safety and Health Act (OSHA), Internal Revenue Service (IRS), Interstate Commerce Commission (ICC), Federal Communications Commission (FCC), Federal Power Commission (FPC), Department of Housing and
Urban Development (HUD), and Department of Defense (DOD). Not only federal agencies, but the grants funded by these agencies have increased the demand for accounting expertise, especially in the suggested formulation of cost-benefit budgets to justify repeated funding of the grants and their parent agencies. Federal taxation is a speciality in itself.

In addition, municipalities and states make investments and compete with business for investor funds. These government bodies also require accounting expertise. Budgets for nearly bankrupt cities such as New York and Cleveland have added to the demand for innovation by accountants.

Innovation is also needed for conglomerate formation and dissolution, and multinational corporations. Transnational corporations have larger and more complex accounting systems than many countries. They have problems of comparable financial information encompassing fluctuating monetary values, legal deficiencies and potential liabilities under the Foreign Corrupt Practices Act of 1977.

Franchise growth is a recent phenomenon. Fast food franchisers as well as franchisers in other areas present their own reporting problems. In contrast, the franchisees are often unaware of these complexities.

Consumer protection in the form of the social responsibility of accountants reached new heights following the social upheavals of the sixties and the disenchantment of the post-Vietnam and Watergate eras. The SEC, Congress, and courts all responded to the issues raised. SEC rulings and congressional hearings center primarily on the issues of independence in connection with the management advisory services offered by CPA firms, and the continued service by one audit firm of the same client, as well as the effectiveness of the Foreign Corrupt Practices Act. At the same time, the courts have responded to litigation regarding the liability of accounting firms in respect of both publicly held and private corporations. The thrust of all three, the SEC, Congress, and the courts seems to converge on a detective role for accountants, as in the 1136 Tenants’ Corporation v. Rothenberg Company suit in New York State. Against this, the U.S. Supreme Court’s 1976 decision in Hochfelder v. Ernst & Ernst further defined “material fact” and auditor liability to reduce third party liability of accountants.

Accentuating these problems are the advent and growth of computer accounting and auditing. Computers increase in sophistication faster than auditing controls. Understanding and controlling
information constantly taxes both accountants and those developing and using computers.37

Thus, accounting from 1960 to the present has had to deal with conflicts of government agencies versus business, and often each other; the public versus business and often the accounting profession; the Courts versus Congress; SEC regulations versus transnational corporations; and the computer versus all of the above. The proactive phase of this cycle affects the watchdog role of the auditor, the independence of accountants, the development of theories and principles of accounting for transnational corporations, accounting for inflation, government accounting and computer systems. The accounting profession responds by compromises and dealing with problems on a continuing basis. Its internal actions include the replacement of the Accounting Principles Board by the Financial Accounting Standards Board (FASB) in 1973. This showed recognition of the interests of other pressure groups. External actions include congressional investigations such as those of Moss and Metcalf. Professional schools of accountancy have been established at a number of universities where the teaching of accounting by functional specialization areas has accelerated. Specializations include financial accounting, auditing, cost and managerial accounting, international accounting, advisory services, taxation, not-for-profit and government accounting, regulatory agency accounting, and specialized accounting by industry.38

The evolving synthesis of this third cycle sees the accounting profession maintaining management accounting services (MAS) and successfully resisting requirements that clients change auditors frequently. However, the AICPA has abandoned its ban on advertising while maintaining one on uninvited direct solicitation. In addition, the AICPA’s board since 1977 includes three representatives of the public. Between 1972 and 1978 the SEC added regulations on peer review, interim reporting, replacement-cost disclosure, voluntary forecasting, and disclosure of services and fees (if they exceed three percent of audit fees) performed by auditors. (The last was rescinded in the fall of 1981.39) Notable is the acceptance by the accounting profession and government regulators of the need for a diversity of principles and theories. This proliferation of generally accepted auditing standards and accounting principles must confuse the most conscientious accountant or investor. The confusion extends to the scope and definition of accounting, of auditing and of financial reporting. For this reason, not only third party lawsuits but also client lawsuits have been increasing in num-
ber and amount of damages sought.\textsuperscript{40} There are unresolved difficulties with financial, cost and managerial accounting for inflation in different countries with varying inflation rates. These may become the problems of the next cycle.

**Conclusion**

The implications and applications of the model presented for future directions in accounting depend upon the acceptance of a pattern of cycles, and acknowledgement that external forces partially define the accountant's role. The economic policies of the 1980s may cause patterns of post World War I and World War II to recur, as business is favored and single-issue groups, or groups hostile to business, are ignored. The future directions may bring continual if not intensified challenges to accounting tradition, supporting Sterling's challenge to the use of conventional financial statements, based on historical cost, for managerial decision-making.\textsuperscript{41} However, the accounting profession has now developed mechanisms to anticipate and/or respond to different factions, to handle the ensuing discontinuities, and to discover answers both of compromise and innovation. Committees meet on a continuous basis and communicate in a non-crisis environment. Even if crises should arise, professional accounting societies and state boards are in place to handle them. Accountants react, proact, and synthesize because accounting principles cannot be formulated in a vacuum, outside the confines of social reality.
# APPENDIX

## PHASES OF SELECTED TOPICS IN TWENTIETH CENTURY AMERICAN ACCOUNTING

<table>
<thead>
<tr>
<th>Topic/Period</th>
<th>Reactive Phase</th>
<th>Proactive Phase</th>
<th>Synthesis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Third Party Liability</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1938 - 1968</td>
<td>New York Law.</td>
<td></td>
<td>1) Gross negligence would equal fraud. 2) The third party had to be the primary user of the audit and this was known to the accountant. 3) Services of public accountants were primarily to the firm. 4) Desire to protect the accounting and other professions.</td>
</tr>
</tbody>
</table>
### Reactive Phase

<table>
<thead>
<tr>
<th>Topic/Period</th>
<th>Pressures</th>
<th>Proactive Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>U. S. Supreme Court.</td>
<td></td>
<td>Negligence is not &quot;aiding and abetting&quot; fraud.</td>
</tr>
</tbody>
</table>

### Synthesis

- 1934—accountant could use a "good faith" defense.
- 1942 SEC Rule 10b-5 (17 C.F.R. 240 10b-5).
- Accountants guilty if they knowingly or unknowingly assist in fraud.
- Hochfelder v. Ernst & Ernst, 503 F. 2d 1100 (7th Cir. 1974) Rev'd 96 S. Ct. 1375 (1976) No liability in cases of neglect.

### Auditing

<table>
<thead>
<tr>
<th>Topic/Period</th>
<th>Pressures</th>
<th>Proactive Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900 - 1905</td>
<td>Banks, industry.</td>
<td>Detailed check for accuracy of historical data for firm, banks.</td>
</tr>
<tr>
<td>1905 - 1933</td>
<td>Shareholders, banks, industry.</td>
<td>Detailed check for accuracy of historical data for firm, banks.</td>
</tr>
<tr>
<td>1933 - 1940</td>
<td>Shareholders, banks, industry, government, liability of auditors.</td>
<td>Check for accuracy of historical data by testing. Add Management Advisory Services.</td>
</tr>
</tbody>
</table>

Detect fraud & clerical error through checking detail, some tests, no recognition of internal controls.

Determine fairness and detect fraud & clerical errors by testing, and detailed analysis, some recognition of internal controls, install accounting systems.

Determination of fairness, detection of fraud & errors by testing—substantial internal controls review.
<table>
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<tr>
<th>Topic/Period</th>
<th>Reactive Phase Pressures</th>
<th>Proactive Phase</th>
<th>Synthesis</th>
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</table>

**Financial Accounting**

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<tbody>
<tr>
<td>1940 - 1960</td>
<td>SEC, industry, industrialization, cost and managerial accounting, inflation, Accounting Research Bulletins, Investors.</td>
<td>Supplementary schedules; LIFO.</td>
<td>Earning power, less reliance on historical cost, supplement conventionally-prepared financial statements with statements of general price-level changes, most detailed financial statements in the world.</td>
</tr>
</tbody>
</table>
FOOTNOTES

1 Parker, p. 15.
2 Baladouni, p. 59.
3 Hawkins, p. 141.
4 Chatfield, p. 232.
5 May, Memoirs and Accounting Thought of George O. May, p. 23.
6 Hatfield, p. 99.
7 Garner, p. 321.
8 Previts and Merino, p. 128.
9 Preliminary Report . . ., p. 35.
10 Final Report . . ., p. 82.
11 Cleveland and Buck, p. 124.
12 Chatfield, p. 207.
13 Zeff, p. 293.
14 Previts and Merino, p. 204.
15 Hawkins, pp. 151-152.
17 May, Twenty-five Years of Accounting Responsibility, Vol. 2, p. 54.
18 Chatfield, p. 276.
19 Storey, p. 3.
20 Devine, pp. 129-130.
21 American Institute of Accountants, Audits of Corporate Accounts.
23 Paton, p. 266.
24 Chatfield, p. 280.
26 Chatfield, p. 181.
27 Storey, pp. 36-37.
28 Chatfield, p. 295.
29 Storey, p. 49.
30 Chatfield, p. 199.
31 Previts and Merino, pp. 332-334.
33 Tipgos, p. 28.
34 "Official Releases," pp. 130-133.
35 136 Tenants’ Corporation v. Rothenberg & Co. 36.
36 Hochfelder v. Ernst & Ernst.
37 Sedgwick, p. 58.
38 Previts and Merino, p. 307.
40 "Lawsuits—They Could Happen To You," p. 8.
41 Sterling, p. 107.

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Dailey: Cyclical Aspects of Twentieth Century American Accounting

EPISODES IN THE AUSTRALIAN TAX ACCOUNTING SAGA

Abstract: Tax effect accounting was introduced into Australia a little over a decade ago. The treatment of the tax effect of losses carried forward and the trading stock valuation adjustment introduced further complications to this new aspect of corporate accounting and reporting. This paper presents an account of the resolution of these accounting issues. It covers the role of professional bodies, companies, and regulatory authorities and the conflicts which arose among them.

The treatment of taxation in the published reports of companies listed on the Australian Stock Exchange (AASE) provides a fascinating saga, in the course of which a number of features of Australian accounting have been highlighted. These may be grouped conveniently under three headings. The first is the adoption of tax effect accounting; the second, the treatment in financial statements of the carryforward of tax losses; and the third, the short-lived trading stock valuation adjustment (TSVA).

The circumstances in which tax effect accounting (the inter-period allocation of income taxes) was adopted demonstrate American influence over Australian accountancy practice. They also demonstrate that it is possible for a reluctant profession suddenly to embrace tax effect accounting because it suits the immediate economic conditions. The treatment of the future tax benefit of tax losses confirms the American influence already referred to, because it was adopted largely through a failure to distinguish the differences in the tax laws of the two countries when the tax effect accounting standard was drawn up. This episode, more importantly demonstrated the power of the Commissioners for Corporate Affairs of the several States and the Commonwealth, to influence and/or determine accounting standards. The adoption of the TSVA is important because it demonstrates the interaction between accounting practice and politics, and the potential consequences of accountants failing to recognize this relationship and its application to what was a very political issue,
With these broad perspectives in mind the following analysis looks at the state of financial reporting pertaining to corporate taxation before these changes occurred and then documents and examines each in turn. At the end of the analysis, there is a summary of the conclusions reached. Some thoughts are added outlining the possible significance of these conclusions for future practice.

**Australian Practice Prior to 1970**

Prior to 1961, the treatment of taxation in the published financial statements of Australian companies could hardly be regarded as satisfactory. Even though the Institute of Chartered Accountants in Australia (ICAA) in 1945 recommended the separate reporting of the tax liability this "could at best be regarded as being followed reluctantly." Where the tax liability was reported, it was accepted that disclosure of the amount estimated as payable in the current year would satisfy the statutory disclosure requirement of any Companies Act. In Australia, this act in each state and territory specifies the minimum content of corporate financial statements. The available evidence suggests that what was almost universally reported was the estimated payment due in respect of the relevant accounting period. Not only was the concept of tax allocation virtually unheard of, but companies saw little reason to explain a discrepancy between the reported tax expense and the prima-facie amount payable found by applying the standard rate of company tax to reported profits. This was the position for reporting corporate taxes until the mid-sixties.

There were factors which introduced significant timing differences between accepted commercial accounting and cost allocation, on the one hand, and the calculation of taxable income, on the other. These timing differences caused little concern in the accounting profession, and there is no evidence of anyone seriously questioning the failure to reflect them in corporate reports. In 1967, however, the Australian Associated Stock Exchanges amended the Official List Requirements to require a company to give an explanation of, and the major items responsible for, any difference of more than 15 percent between the stated amount provided for taxation and the prima-facie tax payable if normal tax rates were applied to the disclosed profit. R. A. McLnnes prepared a survey of current practice in 1968 for the Australian Society of Accountants and concluded that "present practices ... do not follow any cohesive pattern and few [companies] provide a reconciliation with the single amount shown in the published statement." The survey
by McInnes, and other data examined by the author, suggest that, at the time, there was only a limited awareness and acceptance of tax allocation. The attitude of the Australian profession was summed up at the time thus:

. . . This concept implies that assets and expenses have an inherent tax deduction which 'attaches' to the asset or expense until it is matched against revenue. The application of the procedure to the allocation of fixed asset costs in a firm continually acquiring new assets may lead to recording a deferred liability which is unlikely to ever be payable. It reaches its ultimate extreme when a loss is reported reduced by the amount of the future tax saving which may result from the deduction of the loss if profits are earned in the future. The procedure appears more plausible where accrual accounting requires recognition of an expense such as doubtful debts while tax law may recognize only the actual event of finally writing off the bad debt. Interperiod tax allocation is at least as misleading as the non-disclosure of the relevant factors affecting the tax liability.⁸

Tax effect accounting in other countries provided a potent influence on Australian developments. Other studies have demonstrated the readiness of the small professional community in Australia to follow British or American example in company law, accounting standards, and auditing standards. The basis of tax effect accounting was by this time established in the United States and the United Kingdom. The timing of similar developments in Australia supports the conclusion that it was a case of copying techniques used overseas. In this case it was American practice particularly which was followed.

The United States and United Kingdom Examples

The issue of tax allocation was first dealt with by the Committee on Accounting Procedure of the American Institute [of Certified Public Accountants] (AICPA) in 1944⁹ and perhaps received most attention when the declining balance method of calculating depreciation was introduced into the tax code in 1954. A revision of Accounting Research Bulletin No. 44, “Declining-Balance Depreciation” in 1958 increased the recognition of tax allocation by requiring such treatment even where differences between the tax return and the income statement recur over long periods. During the
mid-sixties the matter was under review and Black authored a major research study.\textsuperscript{10} Following this, in 1967, the Accounting Principles Board issued *APB Opinion No. 11* which required comprehensive tax allocation using the deferred method.\textsuperscript{11} The Board agreed by a bare two-thirds majority, not because of disagreement with the concept of tax allocation, but simply because five members favoured partial allocation. By the seventies, opposition of American business had been overcome, and very few companies did not disclose evidence of tax allocation.\textsuperscript{12}

The Institute of Chartered Accountants in England and Wales (ICAEW) issued a Recommendation on Accounting Principles in 1968 proposing that

> A deferred taxation account should be established and maintained at current rates of taxation whenever there exist material taxation liabilities which may crystallise at some future date on profits and surpluses already brought into account.\textsuperscript{13}

As this recommendation preceded the strengthened procedures for formulating accounting standards which eventuated in the seventies, it must be regarded as of minor influence on Australian practice. A survey of reporting by 300 major British companies at that time revealed no direct evidence of tax allocation.\textsuperscript{14} Within three years, however, four out of six of these companies had adopted tax allocation procedures.\textsuperscript{15} It is pertinent to this analysis to pinpoint the date of the advent of an authoritative accounting standard in the United Kingdom. The Accounting Standards Steering Committee (ASSC) issued Exposure Draft ED11\textsuperscript{16} in May 1973 and then prescribed tax allocation in *Statement of Standard Accounting Practice No. 11*,\textsuperscript{17} published in October 1975. That standard established the need for tax allocation in the United Kingdom, even though subsequent reconsideration led to the issue by the Accounting Standards Committee (ASC) of a later proposed amended standard, in Exposure Draft ED19\textsuperscript{18} and the *Statement of Standard Accounting Practice No. 15*\textsuperscript{19} published in November 1978.\textsuperscript{3}

**Audit Confrontations on Tax Allocation**

There is some evidence that the ICAA began serious discussion of the subject of tax allocation late in 1967.\textsuperscript{21} An exposure draft...
was issued and comments invited in November 1967.\textsuperscript{22} This document has the distinction of being the first such exposure draft issued by the ICAA on any subject. By early 1968 it was apparent that the idea of tax allocation, and with it the reporting of future tax liabilities, was gaining ground, and the investment service of the Stock Exchange of Melbourne even accepted it as part of the reporting scene and issued a provisional statement of standard procedure.\textsuperscript{23}

Later in 1968, the absence of general agreement on tax allocation was brought to public attention by a series of widely publicised disputes between auditors and company boards. Initially, public discussion centered on the qualified audit report given by Cooper Bros. (now Coopers & Lybrand) on the annual accounts of Broken Hill South Ltd.,\textsuperscript{24} and Western Mining Corporation Ltd.\textsuperscript{25} Similar disputes arose involving North Broken Hill Consolidated Ltd.,\textsuperscript{26} and the Broken Hill Proprietary Company Limited,\textsuperscript{27} Australia's largest industrial company. These companies are all well known and established companies, at the heart of Australian resource development and industry. It was because of the prominence of the companies and their directors that their disputes with auditors were of such widespread interest. In all cases, the disputes involved the treatment of the rapid write-off permitted, for taxation purposes, of expenditure incurred on major resource projects. The significance of the dispute was not diminished by the stouthearted support for tax allocation given over the same period by another large mining company, Conzinc Riotinto of Australia Ltd. The adoption of tax allocation by this company led to the reduction of profit from $45 million to $23 million.\textsuperscript{28}

The incidents already outlined confirm the view that in Australia there was no automatic acceptance of the concept of tax allocation. The companies which drew attention to themselves, and to the issue, were well-established Australian enterprises which had used their wealth derived from mining to develop a large segment of Australian industry. They were companies directed and managed by persons prominent in Australian industry and commerce, with widespread influence through interlocking directorates and other business associations. Australian academics were active in rebutting the concept, although their arguments were somewhat hidden in the restricted circulation of academic literature.\textsuperscript{29} At the same time, the professional journals did not contain much designed to convert disbelievers.

The auditors involved in the audit disputes referred to had re-
recently formed links with major international firms of accountants. Their support for a particular form of tax effect accounting appears to have flowed from those international associations. Evidence of the forces at work is found by reference to a surrogate, the responses lodged with the Accounting Standards Committee in London to its exposure draft on tax allocation. The tenor of these submissions undoubtedly reflects the world-wide policies of the firms. An examination of these submissions, which are on the public record, showed widespread support for the liability method and opposition to the deferred method which ED11 had advocated. The arguments used relied very much on experience of American practice. It is not possible to refer to similar evidence in Australia because all submissions to the Australian Accounting Research Foundation in response to exposure drafts issued at this time were made on a confidential basis and remain inaccessible.

Statement on Accounting Practice D4 Formalises Tax Allocation

A revised exposure draft was issued by the ICAA in January 1970. In the following November, the ICAA issued its Statement on Accounting Practice D4. This statement recognized the concept of tax allocation and recommended the liability method. This statement was never approved by the Australian Society of Accountants (ASA).

The ICAA did not have any mechanism at this time with which to enforce compliance with its statements. A number of companies either disputed the concept of D4, or found difficulties in introducing this new but voluntary refinement into their accounting. The ICAA was relying on the example of overseas practice rather than on convincing arguments supporting the adoption of tax effect accounting. The Chairman of the Accounting Standards Committee of the ICAA and of the joint ICAA, ASA Accounting Standards Committee recognized this source of authority. He explained his support for tax allocation thus:

There is no need in this article either to explain tax-effect accounting or to elaborate on the differences of opinion which have been expressed, particularly between the profession and academics, on the subject. Suffice to say that the professional bodies in various countries of the western world have taken the view that corporate income tax should be regarded as an expense and as such should be matched in the same way as other expense items
against revenue brought to account in order to determine the profit of a particular accounting period.\(^3\)

In 1971, amendments to the *Companies Act* were passed, first in Victoria and then in the other states.\(^4\) This legislation became effective for financial statements issued by most Australian companies for the year ended 30 June 1973. These amendments were regarded generally as requiring tax allocation, although some companies did not interpret them in this way, as is evidenced by survey results.\(^5\)

It is impossible to separate the impact on company reporting of the recommendation of *Statement D4* from that of the 1971 *Companies Act* because they both became first applicable to company reports at the same time. A survey of annual reports issued in 1973 showed evidence of the adoption of tax allocations by one-third of all companies listed on the Stock Exchange of Melbourne, other than speculative mining companies.\(^6\) As a measure of the importance of this one-third it is noted that the shareholders' funds and assets of these companies represented approximately one-half of all shareholders' funds and total assets of all listed companies.\(^7\) It was also identified that the larger companies had led in adopting the concept.\(^8\)

One of the problems of the legal system governing companies in Australia has been the existence of separate laws and administrative structures in each of the states and the federal territories. In spite of valiant efforts to achieve uniformity, there remain variations both in the law and in its interpretation. The most recent movement aimed at achieving uniformity commenced in July 1982. This involves each of the six states adopting a common code established by the Commonwealth Parliament. This code may only be amended by unanimous agreement of the ministers of the six states and the Commonwealth. It was during an earlier attempt to achieve a uniform administration of company law that a number of the states promoted the formation of the Interstate Corporate Affairs Commission (ICAC).\(^9\) This Commission commenced its activities on 1 July 1974 just over three months before the new *Statement of Accounting Standards DS4* was issued. This standard dealt with matters which were in due course directly to involve the ICAC and test its strength and effectiveness.

*Statement of Accounting Practice D4* was included in an agreement between the ICAA and ASA in September 1973 to review all statements and standards then existing. This revision was done and a new *Statement of Accounting Standards DS4* was issued in
October 1974. This accounting standard was expected to have more impact than the Statement it replaced because it carried the imprimatur of both the ICAA and the ASA and was covered by more stringent obligations by then imposed on members of the two professional bodies to ensure compliance with extant standards.

A survey conducted in 1976 by Christofi provides reliable data on the acceptance of Statement DS4. As was shown earlier, the previous recommendation was followed only by a minority of companies; however, by 1976 three out of four listed companies (based on Christofi's sample of 100 companies) were complying with the standard. A smaller survey by Leppinus confirmed this finding.

An Explanation for the New Enthusiasm

Statement of Accounting Standards DS4 was issued during a year in which companies faced extremely high rates of inflation. Wages were escalating at quite extraordinary rates with equally extraordinary effects on such items as accrued annual and long-service leave. Statutory rights to long-service leave usually involve 13 weeks leave after 15 years of service, with an entitlement to pro-rata payment after 10 years. A rapid increase in wage rates can therefore require a large increase in the provision covering this entitlement. Amongst a business community previously reluctant to embrace tax allocation there was now a headlong race to do so. Auditors were less dependent on overseas example as an argument to persuade companies to adopt tax allocation. They pointed to the combined effect on reported profits of recognizing sudden increases in accrued long-service leave and simultaneously adopting tax allocation. Off-the-record comments even suggested that this argument was used to "clean up" long standing omissions of such liabilities from the accounts of some companies. These provisions are not deductible for taxation until they eventuate in actual cash payments. The potential for this type of effect was well illustrated when the adoption of tax allocation by a major automotive components manufacturer, Repco Ltd., had the effect of transforming a substantial fall in profits to a marginal decrease. Shortly after this, a taxpayer secured a court ruling that part of these provisions was tax deductible but the government soon nullified this decision by amending the law to confirm the previous policy of nondeductibility.

Another factor may well have contributed to the remarkable speed with which this form of innovative accounting was adopted. So long as there is adequate disclosure, the reader and analyst
may calculate an after-tax figure in any desired way. Furthermore, the company is not required to give up the steps necessary to minimize cash payments for taxation in the short term. Most other proposals which relate to profit reporting involve changes in the figures reported which result in profit or loss and therefore may change reported profits without revealing the effect of the alternative. Tax allocation alters the reported tax expense but still reveals the actual tax paid or payable for the benefit of those who prefer to adhere to the earlier and simplistic form of tax accounting and reporting.

There has been continuing public discussion of this issue in Australia. One major company rejected the concept on the grounds that the deferred tax liability would be unlikely ever to arise. Another described it as "an illogical adjustment" and "unwarranted." Some companies' auditors qualified their report because of the failure to adopt tax allocation, while other companies' auditors seemed unconcerned.

**Tax Loss Carry-Forward**

While companies were grappling with the fundamentals of tax allocation, another serious issue was smouldering away and in due time would explode in the midst of the Australian profession. What probably brought the issues together was the increase in depressed business results reported after the economic events of 1975, and the effect on business confidence of the dramatic change of government which occurred on 11 November 1975, when the Australian Governor General, in an unprecedented move, exercised his reserve powers to dismiss a government which held a majority in the House of Representatives.

Public response to the combination of reported trading losses and the tax effect treatment required by *Statement of Accounting Standards DS4* claimed it to be slavish adoption of American practice. This was undoubtedly the case. In Australia, a tax loss cannot provide any benefit until it can be set off against future profits. The application of *Statement DS4* implied an assumption of the American position that a tax loss has immediate value because of the possibility of setting it off against taxable income of the previous two years and securing a cash refund.

*Statement DS4* incorporated a provision which permitted the tax effect of losses to be brought to account, with the qualification that "such a credit would only be justified where there is a reasonable expectation that . . . the company will derive future assessable in-
The equivalent American provision was that loss carry-
forwards may be recognized in the year of the loss where reali-
zation is "assured beyond any reasonable doubt." There is, how-
ever, a significant difference in the environment in which these
authorities operate.

The first case to receive publicity in 1976 was that of textile and
twine manufacturer James Miller & Co., Ltd., which lost nearly $3
million before tax. The company was subsequently sold by the
receiver; in spite of some commentators' views, it was not about
to recover. The columnist Pierpont publicized the danger of bring-
ing into account the future deductibility of the losses, thereby re-
ducing the net loss to $1.6 million. This case was followed within
a month by the publication of the accounts of VACC Insurance Ltd.
This company brought to account the tax benefit of losses of $4.85
million, with which the auditors concurred. The loss thus treated
by VACC Insurance Ltd., was equal to the company's profits during
the past seven years. Under the Companies Act, it is necessary for
a company to appoint a principal accounting officer, who is re-
quired to report on the truth and fairness of the accounts in addi-
tion to the reports made by the directors and the auditor. The
Principal Accounting Officer of VACC Insurance Ltd., who qualified
his report on the accounts, resigned his position the day after the
accounts were published, and most observers concluded that this
resignation probably was not of his own volition. These were not
isolated instances and soon the press carried reports of a series of
such incidents of tax allocation reducing losses. Nylex Corporation
Ltd. issued a preliminary earnings statement which incorporated
the future tax benefit of losses, a case that could be distinguished
from all of the preceding cases because the losses were clearly
due to short-term factors which could be expected to reverse.

Administrative confusion in the operation of company law is
always possible because of the federal structure of Australia. This
has already been referred to in outlining attempts to secure uniform
company law administration. This potential for administrative con-
fusion and conflict over the status of tax allocation was brought to
a head on 17 March 1976, when the Commissioner of Corporate
Affairs in Victoria announced that his office would not continue to
accept financial statements for filing under the Companies Act if

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\(^a\)The company had been hurt by increased imports arising from changes in
exchange rates. Nylex, a plastic manufacturer, was not on the government's list
for major reductions in tariffs. Therefore, a tariff increase on the products of
Nylex would enable the company to recover a market share sufficient to return
to making profits.
they brought to account the tax effect of losses carried forward.\textsuperscript{56} An even tougher stand was taken a month later by the Australian Capital Territory (ACT) Companies Office, which announced that the use of tax effect accounting would not be allowed at all.\textsuperscript{57} At the same time, the New South Wales Commissioner for Corporate Affairs indicated that he would support the application of the professional standard.\textsuperscript{58} There was considerable concern at this, and the business community called for the issue to be settled by the ICAC if it were joined by the ACT, South Australia, and Tasmania.\textsuperscript{59} The accounting profession responded by announcing the appointment of an Accounting Standards Review Committee the day after the statement by the Commissioner of Corporate Affairs.\textsuperscript{60} There was an immediate corporate response, led by Nylex Corporation which, four days after the ACT announcement, reported that the Company was not going to incorporate the tax benefit of losses in the annual accounts as it had done in the preliminary report of two months earlier.\textsuperscript{61} The company chose to comply with the Commissioner’s viewpoint even though it was sure that it would return to being profitable in the future.

At the end of June 1976, the accounting profession announced that \textit{Statement of Accounting Standards DS4} would be amended\textsuperscript{62} and the amended \textit{Statement DS4} was issued in August.\textsuperscript{63} Whereas the previous standard had provided for recognition of the tax benefit of losses based on “a reasonable expectation of future profits,”\textsuperscript{64} the new standard required that the ability to obtain an offset against future profits would have to be “assured beyond any reasonable doubt” and that an asset should not be brought to account unless “virtual certainty exists as to the realisation of the benefit.”\textsuperscript{65} Some commentators expressed the view that the profession had taken a belated step back from the abyss of the abstract.\textsuperscript{66} Within the month, companies were issuing reports which complied with the letter and spirit of the new \textit{Statement DS4}.\textsuperscript{67}

In light of the events of 1976, it is not surprising to find that in subsequent years cases have occurred of companies reversing a policy of bringing the future tax benefit of losses to account when facing the prospect of continuing losses.\textsuperscript{68}

\textbf{The Trading Stock Valuation Adjustment}

The issue of the tax benefit of losses carried forward had hardly been settled before the storm clouds began to gather again. The beginnings of the next event can be traced to the work of the Mathews Committee of Enquiry into Inflation and Taxation, estab-
lished by the Whitlam Government. The terms of reference of the Mathews Committee included an examination of the effects of rapid inflation on taxation paid by companies, with particular attention to the valuation of trading stock and the depreciation of plant and equipment. The Committee concluded that the existing system of taxation was incompatible with business survival, and that although the overall problem would remain even in the absence of taxation, the burden should not be imposed wholly on the business firm. It therefore concluded that there was a need to change the tax base, along with other adjustments to prevent a reduction of business activity which otherwise would result. The Committee's recommendations were aimed at the maintenance of capital to meet inflation needs rather than relieving taxation to increase after-tax profits as an inducement to new business investment.

The Mathews Committee recommended that, in respect to the taxation of business, there should be a recognition of the two most important effects of changing prices, on the cost of goods sold and the cost of using fixed assets. In August 1976, the Treasurer of Australia announced to Parliament in his Budget Speech that the government would make an initial move to implement the Mathews Committee recommendations by introducing a Trading Stock Valuation Adjustment (TSVA) as a form of tax relief thus recognising the problem of financing the increasing cost of inventories.

In view of what developed, it is worth noting that some saw an opportunity to use the TSVA to boost profits. The taxation amendment was introduced following an informal and unpublicised meeting of business and federal government leaders. At this meeting the Prime Minister implied that if the accounting profession had been ready to introduce Current Cost Accounting, it might have been a substitute for the more arbitrary TSVA. The major objective of the government was to provide relief to the financing problem.

In the context in which the TSVA was brought into being, it was not surprising that the accounting profession ruled that the benefit should not increase profits but be transferred to an earmarked reserve to show just how much additional resources had been retained by the company as a result of the TSVA. The profession's Statement was issued with such urgency that, instead of waiting to print it and circulate it to the members of the ICAA and ASA, it was promulgated by advertisements placed in the daily press. There was an immediate appearance of critical comment and letters in the press, leading the president of the ICAA to make a public declaration that, notwithstanding this evidence, there was no dis-
agreement in the profession. A formal Statement of the accounting professional bodies was issued in June 1977 and confirmed the earlier announcement that the equivalent of the TSVA benefit should be credited to a specific reserve account.

Rejection of the Profession's Position

Some companies ignored this recommendation and included the benefit in reported profits. On 1 July the accounting profession abandoned its previous position and accepted the alternative of increasing profits, with the strong recommendation that there should also be an appropriation of an equivalent sum to reserve. What followed could be described only as a confusion of possibilities for reporting the TSVA. During the second half of 1978, a survey of published company financial statements established that only 10 companies (out of the 121 companies surveyed) followed the recommendation on TSVA.

a total of 82 companies disclosed the TSVA in the Notes to the Accounts. These companies used the TSVA to reduce tax expense and increase profits.

and suggested that

Perhaps the explanation for this non-compliance is that the TSVA is of little consequence in terms of aggregates, as shown by the survey results, comparing it to profits or total assets.

The survey results raised the question of whether or not the government would see the profession as obstructing efforts to recognise the impact of inflation on business. But the TSVA was to be short-lived, and the treatment adopted by companies hastened its death. By May 1979, a broker had issued a newsletter saying the TSVA might be temporarily removed. The government may have been swayed by the evidence of companies ignoring the spirit of the agreement that led to the TSVA. At least this provided a convenient argument to justify increasing taxes by removing the benefit. The government departed from the traditional practice of tax changes being embodied in the annual budget, and introduced a series of interim financial measures. The Treasurer, in the course of his speech, said that

There is evidence that many businesses, taking the view that the stock valuation adjustment was an outright tax
concession, have applied benefits from it to increasing reported profits.\textsuperscript{86}

Not only did the Treasurer justify the government's action in this way but the president of the ICAA laid the blame "at the feet of business and accountants alike."\textsuperscript{87} These feelings were also reflected in an editorial of the \textit{Chartered Accountant in Australia}.\textsuperscript{88}

The TSVA situation may be contrasted with the tax loss carry-forward situation. The storm which arose as a consequence of companies reducing their reported losses by taking into account the tax benefit of those losses resulted largely from the failure to recognise that the somewhat liberal position embodied in the American standard can be justified because of the limited ability of American companies to apply losses retrospectively and secure a refund of taxes paid. That episode directed attention to the power of the Commissioners of Corporate Affairs. The stock exchange may establish listing requirements and be successful in improving financial reporting practices and the accounting profession may claim credit for the impact of accounting standards. At the same time, the Commissioner of Corporate Affairs retains the ultimate power to decide whether or not he will accept a representation in a prospectus or an annual report. It is for the Commissioner to decide whether or not there is a proper basis on which auditors and/or directors can affirm that the accounts in such a prospectus or annual report do present a true and fair view of the results of operations or of the state of affairs at the given date. Furthermore, this incident demonstrated clearly that should a Commissioner choose to reject the basis of any particular accounting standard, there is nothing the profession can do to enforce such a standard. In the political tug-of-war which characterises the practical working of the Australian political structure, there remains a strong residue of a readiness to assert the sovereign autonomy of the several states and the Commonwealth. In this case, states-rights clearly won out over the concept of cooperative federalism embodied in the largely ineffectual Interstate Corporate Affairs Commission, which was found wanting.

A more brutal-political reality however, was demonstrated by the events surrounding the short life of the TSVA. A government with severe budgetary deficit problems, aggravated by largesse to taxpayers through adopting partial indexing of taxes for inflation, was desperately seeking ways of increasing revenues. An increase of a few hundred million in tax revenue was possible from removing the TSVA with the excuse that, because business had not used the
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TSVA as intended, the government was morally justified in taking away this concession in the interests of all other taxpayers who, by inference, were innocent of misusing tax concessions. It will never be known whether the result would have been different if companies had satisfied the government by creating a specific TSVA reserve.

A tax deduction similar to the TSVA operated for one year in New Zealand, and has existed in the United Kingdom since 1974. Conflict with professional requirements existed in the early years of “stock appreciation relief” in the United Kingdom, where it is clear from official announcements that it was intended as a permanent reduction in taxation and was not expected that a “clawback” would occur. Nevertheless, the Institute of Chartered Accountants in England and Wales (ICAEW) initially chose to recommend that the stock appreciation relief should be regarded as a tax deferral, to be dealt with through a deferred tax account. Later enactments of stock relief provisions confirmed the intention of granting permanent relief and Statement of Standard Accounting Practice No. 15 issued in 1978 permits the stock relief to be treated as a permanent reduction of taxes.

Conclusion

The first Australian attempt to reconcile the prima-facie income tax payable based on accounting profits and the reported income tax expense were based not so much on acceptance of tax allocation as on the existence of a range of taxation measures leading to substantial permanent relief from taxation. Provisions existed making dividends received by one company from another effectively nontaxable. There were also generous investment allowances and export development allowances, which afforded permanent tax relief to manufacturers in particular. Common practice continued to identify and report the taxation expense for the year as the tax payable for that year of income. This did not necessarily mean that Australian companies and investors failed to recognize taxation as an expense regardless of when payment of taxes might fall due.

It is necessary therefore to look for an external source for the introduction of the further refinement that all revenue and expense items have a taxation effect which must be tagged to the same accounting period. The existence of American standards, and the disposition of company accountants, and auditors of affiliates and subsidiaries of American companies to comply with those standards
regardless of Australian conditions, suggest that the United States was that external source. Methods used there were reflected in readily accessible statements of policies followed by the major international firms of accountants operating in Australia. The initial approach to the treatment of tax losses in Australia can be rationalised only as having been an inappropriate adoption of American practice. There is ample evidence that prominent directors and accountants were not easily persuaded. Nevertheless, adoption of the concept came quickly after the issue of a Statement. The issue of the Australian Statement coincided with unusually high inflation of wage rates and many companies found it convenient to recognise the future tax benefit of related leave provisions to soften the impact of the new wage rates on provisions made for future leave payments. Inflation alone probably would not have had this effect, but it was coupled with the existence of generous statutory entitlements to annual and long-service leave accruing to all employees. Accounting for tax loss carryforwards similarly attempted to graft American methods on Australian conditions. The trading stock valuation adjustment situation revealed the danger of ignoring domestic factors in making such transfers. This analysis provides some useful pointers for the future, not only for Australians. Firstly, it is another piece of evidence of the increasing pervasiveness of American accounting practices and demonstrates the dangers of inadequately recognising local circumstances.

There is also an international accounting lesson of the need to be sensitive to political realities in devising and implementing solutions of accounting problems.

For Australia particularly, there is the added warning of the potential power of the Commissioners of Corporate Affairs. In this instance, the intervention of some of these officers constituted a significant departure from past Australian practice. Convention has left the determination of accounting numbers to the profession, while prescribing by law the items to be disclosed in the financial statements. There has been only a general restriction, that current assets should not be stated above realisable value and by inference that noncurrent assets should not be stated above replacement price. It may be expected that the Australian accountancy profession will consider it necessary to maintain closer liaison with the Commissioners and find means of avoiding further incidents of direct intervention into what the profession would regard as the domain of the professional accountant.
FOOTNOTES

1 While it is not necessary for a public company to seek listing by the AASE, in practice the exchanges have a virtual monopoly and the official list may therefore be regarded as the population of companies whose securities are publicly traded.

2 In Australia, the word "stock" is used in the English sense as equivalent to "inventories." The word "stock" may also be applied to shares in a company which may be described as unnumbered stock units if all the shares are fully paid up. Here, the former meaning applies.

3 ICAA, 1945.
7 McInnes, 1969, p.23.
8 Gibson, 1971, p.231.
9 AICPA, 1961, p.88.
10 Black, 1966.
11 AICPA, 1967.
12 AICPA, 1971, p.192, Table 3-17, shows that 87 percent of the surveyed companies used tax allocation.
13 ICAEW, 1968.
15 ICAEW, 1972, p.44.
17 ASSC, 1975.
18 ASC, 1977.
20 "International ED on Tax Accounting," and IASC.
22 ICAA, 1967, but according to Zeff an earlier exposure draft was published as an article. Zeff, p.27, note 29.
23 "Exchange Suggests Procedure for Future Tax Provision."
24 "Cooper Bros. Differ with Collins House Over $4.4m"; Gottliebsen; Frith; McInnes, 1970, p.2; Byrne, 1978; "Behind the Duchess Closure"; "Phosphate Double Shuffle"; Short, 1978; Maher, 1979; Maiden; "Audit Query on South's Mine Values"; "Auditors Query Assets Valuation by BH South"; "South's Loss Was Too Big."
25 "Cooper Bros. Differ with Collins House Over $4.4m"; Gottliebsen; Frith; Sykes, 1973.
27 "$12.8m Auditing Dispute Throws Hard Light on BHP Accounting Techniques," and Johnson, p.42.
28 Johnson, p.42.
29 Chambers, 1968; Barton; Bayliss; R. Peterson; and also see Chambers, 1970; Buckley, 1970, and Mason.
31 ICAA, 1970.
33 Balmford, p.8.
Victoria, Act No. 8185; New South Wales, Act No. 61, 1971; South Australia, Act No. 52 of 1972, and Queensland, Act No. 8 of 1972.

Robinson.

Refer Note 1.

Gibson, 1976, p.145.

Gibson, 1976, p.146.

"Companies Acts Amendments, Implementing the Interstate Corporate Affairs Agreement."

ICAAC and ASA, 1974; Ogg, 1974.

Gibson, 1979, p.30 et seq.

Christofi.

Another survey of a sample of 250 selected 1975 annual reports revealed that 76 percent of the companies stated that tax effect accounting had been adopted. Ryan, et al., p.3.

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Nilsen Development Laboratories Pty.Ltd. v Federal Commissioner of Taxation 79 ATC 4520 and see McCrann.

Australia, Income Tax Assessment Act 1936 as amended, S51(3).


Byrne, October, 1977 and "Tax Effect Distorting Accounts."

ICAAC and ASA, 1974, par. 15.

ICPA, 1967, par. 45.

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"Nylex Does About-Face on Accounts."; Sykes, April, 1976.


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ICAAC and ASA, 1974, par.15.

ICAAC and ASA, 1976, par.23.

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Mathews Committee, p.i & ii.


Mathews Committee, p.345.

Mathews Committee, p.435.

Mathews Committee, pp.xvi-xix.

Australia, Hansard, No.13, 1976, pp.22-23 and see "How the New Stock Value Scheme Works."

Chanticleer, October, 1976.

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Dunstan, February 1977; Clarke, 1977.
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79"Conflict on SVA is Denied."
80ICAA and ASA, 1977.
81Dunstan, June, 1977.
82"Accounting in Reverse"; McKeon, 1977.
83Chanticleer, September, 1977.
84Gibson and Ong, p.22.
85Chanticleer, 1979.
87Koch.
88"Removal of TSVA."
89See for example "Corporation Tax: Relief for Stock," and Macnair.
90"Tax Relief on Stock Appreciation."

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Statutes

HISTORICAL NUGGETS

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ETYMOLOGICAL OBSERVATIONS ON SOME ACCOUNTING TERMS

Abstract: Selected on the basis of their etymological appeal to the author, eighteen accounting terms are traced to their earliest ascertainable form and meaning in the family of languages to which they belong. Such an investigation not only reveals something of our past, but also helps energize the conceptual landscape of our vocabulary.

An appeal to etymology in order to determine the current meaning of a word is no more reliable than an appeal to spelling in order to determine its present pronunciation. Over time, change of meaning is likely to alter the etymological sense of a word thereby rendering it obsolete or archaic. For example, if an “undertaker” was once someone who undertook to do anything, nowadays he only undertakes to manage funerals. It is established that what a word meant once is not necessarily what it means today. In matters of meaning, present usage is the only scientifically valid criterion.

Be that as it may, a knowledge of etymology can often help give a fuller and clearer understanding of what a word means now. The etymology of a word is its life history—its progressive development in form and meaning in the family of languages to which it belongs. As accountants utilizing English, we are naturally more interested in the development of accounting terms in our own language, but we must not forget that many of them had a long history before they entered the English language. An etymological interest in accounting vocabulary can help not only in revealing our past, but also in making the present meaning of our terms richer and less forgettable.

In the pages that follow are brief observations on some accounting terms, selected on the basis of their etymological appeal to the author.

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I thank Professors Toussaint Hocevar and Michael Dugan of the University of New Orleans for their comments on this paper.
ACCOUNT: to count, to tell, or to think?

There is no need for concern. All three meanings have a place in what we do. As a verb, “to account” assumed the form accounten in Middle English which, in turn, was introduced from Old French, aconter (in Modern French, conter). Going further back in time, we connect aconter to the Vulgar Latin word accommodare or computare meaning to reckon. In Medieval Latin computatorium referred to counting-house. There were also other derivatives from computare. It is interesting to note here that the base of this Latin word, putare, variously meant to prune, to purify, to correct an account, hence, to count or calculate, as well as to think. Aside from the meaning to count, aconter from Old French means to tell. In Modern French, these two groups of meanings are differentiated—compter, to count and conter, to tell (a story). The latter meaning is also retained in the English word.

ASSETS: of which you must have enough

Etymologically, this term is in the collective singular, like alms, riches, and eaves. Today, it is treated as a plural and has a singular, asset. “Assets” has entered our vocabulary via the French. The form it took in Old French was assez, whence assez in Modern French. In Old Provençal, assatz. In all these forms the word means “enough” or “much” as also in the Italian word assai. Both of these senses—enough and much—are found in the Vulgar Latin phrase ad satis meaning in sufficiency. In Anglo-French it assumes the form asetz, whence the legal term aver asetz meaning to have, hence to own, enough to pay one’s debts and other obligations. In case you are still wondering about ad satis, relate satis to the English words satisfy, satisfactory, satiate, etc.

AMORTIZE: intimately related to death

When we say we are going to amortize a debt or an intangible asset, we are referring to the systematic reduction or writing off of a particular account over a specified number of time periods. This use of the term is relatively modern (since late 19th century) and is derived from the French, amortir une dette. Parenthetically, it is interesting to note the interrelatedness of the French word dette and the English “debt,” which in Middle English was spelled in the same way as the French. Returning to the word “amortize,” in Middle English amortisen, we find that it has found its way into English from the Old French amortir. The French’ form came, in
turn, from the Vulgar Latin, *admortire* meaning to deaden or extinguish. *Admortire* is made up of *ad-* expressing direction toward something, and *mortuus*, dead or *mors*, death. The original meaning of the word was simply to kill or destroy. The term "mortgage," which comes from the Old French of the same form, translated literally into "death pledge."

**AUDITOR:** was once listened to

Auditor is one of the many words, such as audible, audience, audile, audition, auditorium, obedient, obeisant, which come ultimately from the same Latin root *audire* meaning to hear. The English "auditor" corresponds in form to the Latin *auditor*, a hearer. And *auditus* meant a hearing, whence the English "audit." Auditorium," which is borrowed from Latin in its original form, means literally a place where something is heard, hence a lecture-room or a hall of justice. The connection between the auditor of our times and *audire*, to hear, comes from the fact that in the early periods of our profession, those responsible for attesting to the fairness of accounts presented their reports orally to, for example, the lord of the manor or, in the case of state affairs, the king, and were therefore heard or listened to.

**BUDGET:** it was just a leather bag or wallet

In the Middle Ages, French merchants carried their money around in a *bougette*, a small bag. This word descended from the Latin *bulga*, a leather bag. The English word "bulge" comes from the same source, carrying the idea of swelling. In times past, a storekeeper who made up his budget opened his bag to find out what were his resources. The Chancellor of the Exchequer, in making his annual statement to the British House of Commons, once opened his budget by saying: "This bochet [budget] with othre lettres conteigned in the same" (early 16th century). The controller of a modern American corporation does not, obviously, carry a *bougette* of any sort except his personal wallet which may be surmised to contain credit cards, without which he does not dare to leave home.

**CAPITAL:** *caput* or, simply, head

In the sense of wealth, the word "capital" comes ultimately from the Latin *caput* meaning head. The Latin root of *caput* appears in scores of English words, some of which have come to us through
the French and others directly from the Latin. Both of our words "capital" and "cattle," for example, are from caput, for in early days a man's wealth was reckoned in chattel, a doublet of cattle. Interestingly, we still speak of a herd of a thousand head. The Latin adjective capitalis meant pertaining to the head, whereas capitale in Late Latin referred to stock or property. Aside from its meaning "pertaining to the head," capitalis also meant chief, first. The latter meaning has found common use in accounting terms such as capital asset, capital budget, capital gain, and capital expenditure. In reference to wealth, capitalis implied a man's principal or chief substance.

SECURITIES: literally translates "without care"

The name for these sometimes volatile investments has a ring of assuredness about it. And this is not altogether unfounded. The term "securities" descends from the Latin words se- meaning without and cura, care. If you possess enough securities, you should be able to live a carefree life, confident of your financial well-being! One type of securities, the stock, comes from the Old English stocc meaning a tree-stump. Unquestionably, this sounds solid enough. But how it came to be applied to securities no one seems to know. The other type of securities, the bond, can be traced to most Teutonic languages, including the English where it also assumes the form "band." "Bond" is a mere variation of "band" meaning a fastening. This word connotes fixedness, steadiness or, simply, securing. Legally, a bond binds the issuer to the holder of the bond.

CASH: came from the till

"Cash" came either from the early modern French casse or Italian casse. In turn, both of these words came from the Latin capsa. They all meant chest, box, case, or repository. Later on, casse came to mean the money, or cash itself. Speaking of money, this term has an interesting origin. It comes to us from a Roman goddess, Juno Regina, queen of the heavens. Juno assumed many divine responsibilities but most of all she was the goddess of warning. The Romans were so grateful to Juno for telling them about the dangers ahead on various occasions that they built a temple to her, and when coinage was devised they set their mint in her temple, and thus Juno came to be known as Juno Moneta, guardian of finances. Her name Moneta was derived from the Latin word moneo, warn, and

^But see Baxter, p. 167 in Vol. 11, No. 1.
finally entered Old French as *moneie* and thus eventually became our word “money.”

**REVENUE:** tells us of money that has come back

“Revenue” is another word that came into our language through the French. It originated in the Latin *revenire*, re- meaning again or anew, and *venire*, to come. In Middle French the word “revenue” assumed the form *revenu*, the past participle of the verb *revenir* meaning to come back again or, simply, to return. When a businessman invests a certain amount of money to acquire goods for resale, he hopes that upon selling the merchandise enough money will come back to enable him to recover the cost of the goods along with other related costs incurred, and hopefully more. Revenue, of course, is not the money itself. It is merely an indicator of an ownership claim; but it also tells us the amount of money that either has come back or will eventually be realized upon collection.

**PROFIT:** a sign of progress

“Profit” comes from the Old French word of the same form. In Old (and Modern) French the verb form is *profiter*, while in English it retains the same form as the noun, to profit. The English adverb “profitable” is adopted without change from the Old French. *Profit* in Old French is derived from the Latin noun *protectus* meaning advancement, improvement, progress. *Protectus* is the past participle of *proficere*, to progress, to help forward, hence to yield a profit. It is interesting to note that the statement of profit and loss, known to us as an income statement, may on occasion be referred to as a progress report, in contrast to a status report, which refers to the balance sheet or statement of financial position. Aside from the sense of financial progress or advancement, the word profit has a wider use, that is, an advantage or benefit of any sort that accrues to a person, community, or thing.

**JOURNAL:** a daybook or an account of day-to-day events

In Modern French, *journal* literally means daily. Going backward in time, we find that *journal* is derived from Middle and Old French *journée* meaning day. The latter was derived from the Vulgar Latin *diurnata*, a day’s work or travel. *Diurnata*, in turn, is derived from the Latin *diurnals*, *diurnus*, of the day or daily (*dies*, day). The English word “diary” is also a descendent of the Latin *dies*. Often, the words “diary” and “journal” are used interchangeably.
“Journey” in English is another word that has its roots in the French journée and Latin diurnus. A “journal” was at one time called a daybook. In modern times, a journal is a record in which financial transactions and events are first recorded, manually or through a computerized system, but in earlier centuries a daybook was used for recording transactions, often in narrative form, to which if you add the recording of other activities, as well as reflections or feelings, you obtain a diary. In times past, it was not unusual for a merchant to maintain such a diary that informed him of more than just monetary transactions.

LEDGER: a book lying in one place and open to inspection

Today we think of a ledger as a collection of accounts—a volume of columnar pages, the printed output of a posting machine, a set of punched cards, or a section of magnetic tape or disc. This term has entered our vocabulary from the Middle English legger which probably came from liggen meaning to be lying down or situated. This seems to be the fundamental notion which one finds expressed in the following meanings that the word has assumed: horizontal timber or bar; resident ambassador; stationary. Originally, it also meant a book lying permanently in one place. One is tempted to surmise that this last meaning applies to the accounting book known as the ledger, a book of final entry. In sixteenth and seventeenth century England, as well as later, the company ledger was permanently available in the counting-house for the merchant-shareholders’ inspection.

COST: Hoc constat mihi tribus assibus

Sometimes one is led to believe that “cost” is the accountant’s middle name. To be sure, it is one of the most frequently used words in accounting. As we try to look at the life-history of this term, we find ourselves traversing a well-known etymological path. “Cost,” or costen in Middle English, comes from the Old French coster or couster (Modern French, couter) meaning to cost. The noun form in Old French is cost and in Modern French, coût. In Provencal, cost, in Spanish and Italian, costo. These words, in turn, come from the Latin constare which means to stand firm, be fixed, stand at a price. Constare is made up of con- (intensive) and stare, stand. In case your Latin did not help you with the idiomatic expression in the subheading, it simply means “This ‘stands me in’ at three asses.” Obviously, a bargaining statement.
TRANSACTION: *agreement by mutual concession*

Among other meanings, to transact has meant to do business, treat, carry through, and manage. The noun “transaction” has its origin in the Latin *transactus*, past participle of *transagere*. The latter is a compound of *trans-* meaning across, beyond, to the other side, through and *agere* meaning to drive, to set in motion, to do. Thus *transagere* variously means to carry through, to achieve, to accomplish, to come to agreement, to settle. We can readily see the connection between *transactus* and transaction. A transaction is indeed the result of an agreement reached by two independent parties. It is this result which makes it the basic stuff or material of accounting analysis.

DEPRECIATION: *literally a lowering of the price paid for goods or services*

Despite the change in meaning from the Latin *depretiatus* to the accounting term “depreciation,” the etymological tie is undeniably there. *Depretiare* in Latin means to price down. This pricing down is made up of *de-*, from, down, away, and *pretium*, price. The Latin *pretium* becomes in Old and Middle French, *pris* and Modern French, *prix*, which was adopted into Middle English, whence the English word “price.” It is interesting to note that “to price” came from the noun “price” rather than from *prisen*, in Middle English meaning to value, to esteem highly, to prize. “Prize” as a verb occurs in the compound word “apprize” meaning to put a value on. To get back on track from our brief side trip, in its technical sense “depreciation” today refers to the reduction (lowering) in value (price) of tangible, long-lived assets (goods [capital] but not services) from use or obsolescence.

DEPLETION: *the emptying out, the drawing off, exhausting*

Its origin is in Latin. *Depletus*, past participle of *deplere* meaning to empty (*de-*, away and *plere*, fill). The noun from the verb *plere* is plenus, full, from which comes the word *plenarius*, that is, plenary. A plenary session at a convention should, therefore, be full. It is the kind of session to which all participants should go. Of course, some, for a variety of reasons, cannot make it. After the session is under way, we find that at various times, again for a variety of reasons, the plenary session depletes as some participants tip-toe out of the vast meeting-room. When this happens, as it often does, *deplere* or emptying out is taking place. Among the
various uses acquired by this word *deplere*, we find one of a rather specialized nature, *depletio* or *depletura* meaning blood-letting in Late Latin.

And, finally,

**DEBITS EQUAL CREDITS: the accountant's balancing act**

Based on my musings to this point, you must have become amply aware that etymology attempts to trace words to their ultimate source or origin. Such tracing is essentially in terms of form and meaning. In my foregoing observations, something of a word's changing form and meaning has been emphasized. The words "debit" and "credit," however, present us with a challenge. We come to realize that although "debit" comes from the Latin *debitum* meaning debt and "credit" from the Latin *creditum* (ultimately from *credo*, I believe) meaning thing entrusted to one, the modern meaning of debit and credit cannot in any way be related to the original words. While form is there, the threads of meaning are not; or to put it somewhat differently, the etymological significance of these words has faded away.

What meaning do we, then, ascribe to these words today? Sometimes we hear accountants say that debit and credit are synonymous with plus and minus. This, of course, is not true for what is plus for some accounts (debits to asset and expense accounts) is minus for other accounts (debits to liability, capital, and revenue accounts). The opposite holds true for credit items. The lack of consistency in meaning invalidates that notion. On occasion we also hear accountants say that debit in a manual system refers to the left side of a ledger account (when the ledger account is in the form of T) and credit, to the right side. While this may be so, we find it difficult to extend this meaning to computerized accounting systems where the magnetic tape makes no such distinction.

I would like to submit that the most tenable meaning that can be attached to the statement "debits equal credits" is, as you

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*cOne reviewer of this paper wrote: "I felt the meaning of debit and credit was descendant from Medieval Italian terms "debitor" and "creditor." Debitor, if I remember correctly, originally meant "one who owes" as in an asset which owes its benefit to its owner. Similarly, creditor meant "one who owns." The asset "owes a debt," namely itself, to its owner—the person to whom it was entrusted." In their Accounting Theory: Continuity and Change, Littleton and Zimmerman write: "debit-credit (in this case the original meaning of "he owes,," "he trusts," is now quite uninformative)."

*dIt has also been suggested that these words are derived from the Latin *dehabet* and *credidit*, operations whereby a slave was charged and discharged with accountability for the master's capital.*
guessed it, the accountant's balancing act. Since the accounting analysis of business transactions finds its articulation through a dual or twofold classificatory scheme, it is no surprise that a pair of terms is needed to make that distinction; hence, the terms "debit" and "credit." While it is entirely arbitrary why historically assets have acquired the designation of "debit" and equities, "credit" balance, the fact remains that in the performance of his professional duties the accountant is necessarily committed to a balancing act.

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THE "ROOTS" OF ACCOUNTING

Abstract: This paper presents some evidence that rudimentary accounting (economic recordkeeping) may have predated both counting and writing.

In the past ten years numerous articles, books and other productions have exposed the "roots" of various segments of society. Such fascination with the discovery of one's past might excuse accountants for momentarily glancing away from proforma statements of the future to catch a glimpse of their own "roots." Just how deep into history, or prehistory, do the "roots" of accounting reach? There is some evidence that accounting (economic recordkeeping) may have predated both counting and writing.

Primitive Recording—Real System Space Ordering—A Precursor of Mathematics?

Perhaps the simplest function of what is currently called accounting is the arranging of the elements of a given system to provide a particular required piece of information. For example, all of the goods "owned" by an individual are placed in a space designated as "his/hers." Such "real system space ordering" may be the initial expression of the recording function. If this is the case, accounting has "roots" that reach very deeply into history.

There is evidence that the concept of ordinal (directly space/time related) numbering may have preceded that of cardinal (quantitative) numbering.¹ The ceremonial rites of very ancient peoples enacting creation myths required the specific time ordering of the actors. A similar rudimentary sense of numbering has been shown to exist also in certain higher animals.² Ball describes the spatial ordering required by the counting efforts of primitive people as follows:

Up to ten it is comparatively easy to count, but primitive people find great difficulty in counting higher numbers; ap-
Apparently at first this difficulty was overcome by the method (still in use in South Africa) of getting two men, one to count the units up to ten on his fingers, and the other to count the number of groups of ten so formed.³

This method of counting uses spatial arranging (ordering) of real system elements to achieve a quantitative solution. It shows how cardinal numbering may have emerged from real system space ordering in a particular setting. Ball indicates the possible instrument of general transition from ordinal to cardinal numbering when he points out that

the almost universal use of the abacus or swanpan rendered it easy for the ancients to add and subtract without any knowledge of theoretical arithmetic . . . they afford a concrete way of representing a number in the decimal scale, and enable the results of addition and subtraction to be obtained by a merely mechanical process.⁴

The statement that the most primitive forms of both accounting and counting may be expressions of real system space ordering does not in itself suggest that one predated the other. However, it does link accounting and counting to a common functional development. In human societies, functions tend to develop over time initially from the simple to the complex. Consequently, a common linkage to a functional development would have dating implications, however imprecise they may be.

The proposition that accounting may have emerged prior to, or at least concurrent with, counting is based on the following two ideas:

1. Developments in both rudimentary accounting and counting appear to be driven by economic need.
2. The incipient accounting space ordering seems to be of a more primitive expression than the space ordering associated with the emergence of counting.

Boyer supports both ideas in his statement,

It is clear that originally mathematics arose as a part of the everyday life of man, and if there is validity in the biological principle of the "survival of the fittest," the persistence of the human race probably is not unrelated to the development in man of mathematical concepts. At first the primitive notions of number, magnitude and form may
have related to contrasts rather than likenesses—the differences between one wolf and many.\(^5\)

His identification of "notions of number, magnitude and form . . . related to contrasts" as precursors of counting indicates that these ideas predate counting. It appears that the most primitive expression of accounting would include these ideas. Consequently, accounting would predate counting. The scenario may be that economic need first drives space ordering by contrasts (the separation from the kill of one deer to one's own space) followed by space ordering by likenesses as economic interaction (trade) develops.

Scott strongly supports such a scenario. Discussing the Sumerians, he declares:

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[T]here is unmistakable evidence that a rudimentary form of mathematics played no small part in their lives. Barter leads at once to the fundamental operations of counting and adding, of weighing and measuring, and an appreciation of simple geometric forms. . . . Moreover, people depending upon the fruits of the earth for their existence had need of some form of calendar to indicate the recurrence of the seasons.\(^6\)
\]

Because it may be identified with precursors of counting, rudimentary accounting may predate counting and thus mathematics. However, it is possible that the two developed in such a close relationship that concurrent development would be a better description of their emergence. Perhaps counting was a conceptual system that developed in parallel with the real accounting system. Research related to this possibility may contribute to a better understanding of the current development of accounting.

**Prehistoric Abstract Recordkeeping?**

Real system space ordering could be quite restrictive as a recording device. By abstracting the order (or information) from the real system, one might allow the real system to be manipulated without destroying the record. Even this more advanced form of the recording process appears to have emerged very early in man's existence.

The prehistoric emergence of abstract recordkeeping is documented by the work of Schmandt-Besserat. Tokens, which are clay models of various shapes representing specific commodities began to appear in the Middle East about 8500 B.C.\(^7\) With the emergence of cities, about 3500 B.C., the token system underwent evolutionary
changes and clay envelopes containing tokens began to appear. Schmandt-Besserat describes her work:

My own contribution since 1974 has been to document that tokens, such as those found in the envelopes, were found loose in most sites of the ancient Middle East. I proposed that they were part of a recording system commonly used prior to writing. By tracing the earliest tokens in the incipient farming communities of the ninth millennium B.C., I provided a link between the need for and invention of recording and the beginning of agriculture. I was able to draw parallels between the shapes of the tokens and those of the first signs of writing and to point out the relationship and continuity between the two recording systems.

Schmandt-Besserat observed that, except for rare occasions, the tokens found at large were made with great care and fired and enclosed in clay or metal vessels. From this evidence she suggests that “tokens of specific accounts were kept in special containers.” On the other hand, the tokens found in envelopes, while identical in shapes, were smaller and cursorily manufactured. This suggests that the tokens and envelopes may have been manufactured in the presence of involved parties and that the purpose of the invention of the envelopes seems to have been the need to confer an official character on certain transactions through the use of a seal.

While the envelopes form the direct impetus for the invention of writing, it is particularly important to observe that the tokens themselves formed a widespread abstract recording system over a period of some 5,000 years and over a wide spatial area. “The homogeneity of the group of artifacts strongly suggests that they all served an identical function and that the messages contained in the form of tokens were intelligible from Elam to Palestine.”

It should further be observed that all of this happened in prehistory, before the invention of writing.

Schmandt-Besserat concludes:

About 200 spherical clay envelopes (including fragments) have been recovered in an area extending from Palestine to Iran, including Saudi Arabia. The seals impressed upon their surface indicate their formal character, and it seems clear that the tokens they contained stood for goods and stated liabilities. The envelopes would have remained of esoteric interest but for the discovery of their relationship to the invention of writing. Indeed, their evolution illus-
trates no less than the transition between an archaic abacus and writing according to the following sequence: (1) the invention of envelopes to hold tokens of specific transactions; (2) the impression of markings on the surface of the envelopes to indicate the shape and number of tokens included inside; (3) the collapse of the envelopes into clay balls or tablets bearing impressed signs; and (4) the elaboration of the impressed signs into incised pictographs.¹²

Braidwood and Bell indicate that the development of writing can be traced step by step from the pictographs to the cuneiform writing.¹³ Modern language is traceable back to the cuneiform.

Conclusion

This account of the evidence that the "roots" of accounting can be traced to prehistory raises some very interesting questions for accounting theorists. Can such deep roots exist without accounting being quite fundamental to the advancement of the human race? Have accountants generally viewed their function too narrowly?


George C. Mathews, one of the first commissioners of the Securities and Exchange Commission, was charged with general supervision over accounting matters brought before the Commission. Under his leadership, the office of Chief Accountant was established, Accounting Series Releases were initiated, and the basic framework for handling accounting matters was formulated.

The Securities Act of 1933, a product of the “New Deal” legislation, was proposed by the Roosevelt administration. The primary objective of the Act was to protect investors from false information in the securities markets. First administered by the Interstate Commerce Commission, the 1933 Act was transferred to a Securities and Exchange Commission (SEC) in 1934. It is often called the “truth in securities” law, and the Senate Committee on Banking and Currency listed the following as being among the major purposes of the Securities Act of 1933:

1. To prevent the exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; and
2. To place adequate and true information before the investor.¹

To accomplish these objectives, the Act required any firm issuing securities for public sale to file a registration statement and to provide a prospectus that contained most of the information filed with the Commission. The SEC did not attempt to judge the merits of an issue, but assumed that disclosure of information would allow the investor to make an informed choice among alternative investments.² An integral part of this philosophy was the work of one of the first Commissioners of the SEC, George C. Mathews.

George C. Mathews, born 1886 in Northwood, Iowa, was graduated from the University of Wisconsin in 1908. After graduation,
Mathews spent a year at Oregon Agriculture College (1909-1910) as an instructor of general business subjects before joining the Railroad Commission of Wisconsin as a rate expert (1910-1912). Apart from a brief period with a public accounting firm (1916-1917), Mathews held positions with the state of Wisconsin, each of which demanded a greater degree of managerial and technical ability. Starting in 1912 as a statistician in charge of the Utility Rate Department, Mathews later became director of the Securities and Statistics Division (1925-1931) and then was appointed director of the Securities Division and at the same time Chief Examiner, Public Services Commission of Wisconsin (1931-1933). Mathews left the state of Wisconsin in 1933 to become receiver for the bankrupt Middle West Utilities Company. However, through Senator Robert M. La Follette, Jr. (Republican, Wisconsin), Mathews was appointed a member of the Federal Trade Commission in charge of securities in 1933. The function of monitoring the sale of securities was, a year later, transferred to the newly established Securities and Exchange Commission, at which time Mathews became a Commissioner.

Mathews, along with Robert E. Healy from Vermont, was one of the two Republicans appointed to the SEC in the summer of 1934. While conservative by nature, Mathews was described as a zealot on the question of preventing the flotation of fraudulent securities. His appointment, though due in part to political considerations, was primarily based on Mathews' years of experience in the state of Wisconsin. There Mathews had helped develop security (called "blue-sky") legislation. In a speech made in 1929, he revealed his attitude toward blue-sky legislation.

The essential feature of blue-sky legislation is the intent to prevent fraud and unfair practices in the sale of securities. It is not the function of such legislation to protect the purchaser of securities against such danger of loss as may be inherent in the security which he buys. Neither is such legislation designed to prevent the purchaser from speculating if he desires to do so. It is designed to assure, as far as its administration can accomplish this purpose, that the buyer of securities is not misled as to the real nature of what he buys, that where he is buying speculative securities he be sufficiently advised of that fact, and that he have in return for the risk which he assumes, a fair chance for speculative profit.
Blue-sky legislation is in a measure paternalistic but that paternalism is not intended to limit the individual in taking risks with his money. It protects him only to the extent that it interferes with the right of someone else to sell him securities which in themselves are fraudulent or unfair or to sell him any securities by fraudulent or unfair methods.5

The key theme in Mathews' philosophy was that the "buyer of securities is not misled" and that security regulations were "not intended to limit the individual in taking risks." Both of these concepts led him to conclude that disclosure was the primary ingredient of a free economic system, a belief Mathews maintained throughout his tenure at the SEC.

Since Mathews had some accounting training and a background in administering "blue-sky" laws, he was chosen to supervise accounting matters brought before the Commission. Initially, Mathews had two concerns, to establish basic rules or guidelines from which one could administer the newly created Commission and to formulate the structural framework necessary to insure that the newly created guidelines were consistently applied. To accomplish the former, Mathews often communicated directly with accounting firms, stating the Commission's thoughts concerning a particular problem. Since Mathews was given great latitude concerning accounting matters, his comments reflected his own concepts as well as the attitude of the Commission. For example, in a letter dated December 3, 1934, shortly after the SEC was formed, Mathews stated the function of disclosure through financial reporting:

I should like to correct also any impression that you may have that the Commission regards your present proposal as a compromise [emphasis added]. The Commission's duty is to have the facts accurately stated and adequately disclosed. It cannot settle any issue raised in a registration statement or a matter of compromise.6

The second area of concern to Mathews, establishing a structural framework, took longer but possibly has had a more profound effect on the Commission. He began by bringing into the Commission people with similar philosophy toward financial reporting as his own. Most notable of these was Carman G. Blough, who was hired in the fall of 1934 as a financial analyst, but quickly promoted to assistant director in the Registration Division in 1935, and then made first Chief Accountant of the Commission later in the same
year (1935-1938). The two were also close friends. Together they formed a partnership that helped formulate the basic structure within the SEC for handling financial reporting. This structure, which to a large extent still exists, allowed the American Institute of Certified Public Accountants and later the Financial Accounting Standards Board to grow into effective rule-making bodies.

Shortly after the SEC was organized in 1934, Congress passed the Federal Public Utility Act of 1935. In an interesting speech given at Northwestern University on October 14, 1935, Mathews pointed out the differences between the Securities Act of 1933 and the "... new task with which the Commission is confronted." After noting that the 1933 Act pertained to sales of securities sold to the public through the mails or in interstate commerce, Mathews continued to advance the philosophy of full disclosure.

Its [the Commission] only function is to make sure that certain information regarding the security and the issuer is made available to the public. Of course, publicity tends to discourage some of the more flagrant abuses, but many registration statements not limited to those of utility companies, reveal continuing financial practices which may be severely criticized.

Under the Securities Exchange Act of 1934, the Commission is given extensive authority to regulate the business of dealing in securities, but here also its powers over the companies whose securities are traded in on the market are essentially limited to requiring the disclosure of adequate information for the guidance of investors.

Later in the speech, while discussing the Federal Public Utility Act of 1935, Mathews advocated that a more positive stance be taken by the government.

One of the most important and one of the most difficult tasks given to the Commission is that of regulating the keeping of accounts by companies which are subject to its jurisdiction. This is covered by Section 15. You are, no doubt, familiar with many of the complexities that have resulted from the natural desire to make a favorable impression on the investor and at the same time not to appear too opulent to the rate payer and the tax collector. In most instances, it would obviously be desirable to have all companies keep their books in the same way. [emphasis added] Not only would this save a great deal of time
and money in rate and tax litigation, but it would give the investor an intelligent basis for judgment. Considerable progress towards uniformity has resulted from the Uniform Classifications of Accounts for Electric and Gas Utilities adopted by the National Association of Railroad and Utilities Commissioners. The adoption of any further standardization of accounting methods is a tremendously difficult problem and one which must be approached with great deliberation. At every stage, of course, there will have to be the fullest cooperation with State Commissions as well as with the Federal Power Commission.\(^\text{10}\)

It appears that Mathews either was not aware, or possibly not concerned with the differences in accounting procedures dictated by the two acts. There may be several reasons for his not taking note of these differences. First, Congress in the body of the later legislation made it extremely clear that many public utility holding companies had abused their privileged position and needed to be closely regulated. For Mathews to have advocated a position similar to the Securities Act of 1933 would have substantially weakened his position on other matters. Second, Mathews was appointed receiver for the Middle West Utilities Company (June-October, 1933). During that period, Mathews could see the problems associated with such holding companies. Third, Blough stated that Mathews and he were fully aware of the administrative problems associated with the formulation of accounting principles, and were adamantly against the establishment of a uniform set of accounting procedures that would affect all business concerns.\(^\text{11}\)

This, however, did not stop Mathews from continuing to strongly advocate a more uniform application of accounting principles. In 1936, Mathews wrote a letter to Eric Kohler, president of the American Accounting Association, noting the disparity of opinion among accountants regarding many matters which to him seemed to be fundamental to financial reporting. Mathews said that "While accounting probably can never be an exact science, there must be basic principles whose general recognition would tend toward soundness and uniformity. The delineation and development of these principles is as much within the field of scientific research as any problem in the natural sciences."\(^\text{12}\) There were, however, practical limits on the conduct of scientific research by practicing accountants.

First of all, the profession of accountancy has by no means reached its goal, either as to standards or as to
qualifications of practitioners. Secondly, it is a highly competitive business with a clientele which is often very insistent on its views as to how its business conditions and results should be set out. The public accountant who insists on rigid compliance with standards much beyond those generally accepted is, at the least, at a competitive disadvantage.¹³

Mathews then found himself in a quandary: though he did not advocate the development of standardized accounting practices, he felt the accounting profession, due to economic competition, would not be able to develop a strong basis from which one could produce uniform accounting methods. While never completely unraveling this discordancy, Mathews was at least willing to work within the confines placed before him. Instructing Blough to make speeches indicating the need for further development of accounting principles, Mathews also began to speak out and write articles to stress the need for more consistency in the use of accounting principles. A list of Mathews writings and presentations appears at the end of this paper.

Mathews stated in a 1937 address before the Convention of the Investment Bankers Association:

We have only recently reached the point where serious consideration is being given to the use of the powers conferred by Section 19 (a) for the purpose of announcing rules to govern the handling of certain accounting matters. To the extent that these powers are invoked, I anticipate that their use will be a matter of gradual development. The attempt to secure a general recognition of sound principles and practices should not blind us to the dangers of rigid standardization. If the purpose of accounting is to secure a correct picture of financial condition and results, great care must be taken that the picture not be distorted by application of rules which may defeat the purpose.¹⁴

Again, in a September 1938 article, Mathews stressed the problems associated with developing uniform accounting principles. He said:

The Commission also responds to the accountant's desire that he should not be given a too rigid standard, for it recognizes that the practitioner has the firsthand experience with actual materials and problems of business. The environment itself operates as a stimulant
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to creation and development of accounting principles. The books and records of living business suggest alternatives to the auditing accountant, possibilities of whose very existence a reviewing administrative body may be unaware. And, if several years of administration of the legislation have taught us anything, it is that in large portions of the field of accountancy, we cannot predict that tomorrow's case can be adequately handled by today's technique.15

Coupled with these measures, Mathews began to see the need to publish opinions concerning accounting matters that would have universal appeal. On April 1, 1937, Accounting Series Release (ASR) No. 1, "Treatment of Losses Resulting from Revaluation of Assets," was issued. Blough in a letter dated April 5, 1937, summarized the new release. Surplus would have to be flagged in all subsequent statements filed with the Commission in such a manner as to clearly reveal the facts relating to the write-off of the property and the effect that the write-off would have had upon earned surplus had it been handled in accordance with the opinion stated in the ASR.16 Interestingly, even though Mathews strongly advocated following the opinions stated in the ASR, he was willing to accept a registration that violated the principles communicated in the release provided the accountant stated in the audit opinion which alternative procedure had been followed.

This concept of adequate disclosure being the sole governing factor in accepting a registration was stretched and finally, to a degree, broken with the passage of ASR No. 4, "Administrative Policy on Financial Statements." The registration that led to this ASR concerned the Northern States Power Company. In 1934, the company filed a registration which disclosed that it had, in 1924, written up fixed capital and investment accounts by about $8,000,000, with a corresponding increase to the capital surplus.17 The Commission thought the practice "improper" but accepted the statement in a three to two vote, provided there was a footnote disclosing the questionable practice. Mathews was able to influence the majority of the Commission, consisting of James Landis, Chairman, and James D. Ross (known as J. D.) to vote for the disclosure requirement. This was probably not very difficult for "Mathews . . ., on whom his friend Landis leaned more than any other Commissioner, and whose ability to digest and interpret facts, has made him invaluable."18 About J. D. Ross not much is known, apart from the comment of William O. Douglas in Go East Young Man, "in the
early SEC days J. D.'s job was a sinecure." Possibly he always voted with Landis, or perhaps against Douglas.

William O. Douglas and Robert E. Healy were not satisfied with the decision, and during the two years 1936 and 1937, were able to modify it. During this period, the Commission meetings often resulted in heated debate between Mathews and Douglas each advocating their own philosophy. However, not until the membership of the Commission changed did the precedent established by the Northern States Power Company case change. James Landis left to become Dean of Harvard Law School, and was replaced as chairman by Douglas on September 21, 1937. Landis's successor, Jerome Frank, was a lawyer who had been recommended by Douglas. Additionally, a fifth new member of the Commission, John W. Hanes, replaced J. D. Ross. The American Institute of Certified Public Accountants, then called the American Institute of Accountants, had little influence on the decision process. John Carey, secretary for the Institute, stated that they did not lobby the SEC to influence the final outcome but relied on what he termed "truth."

On February 12, 1938, the Commission directed Mathews to select a committee of accountants within the Commission, headed by the Chief Accountant, Blough, to begin work on "rules prescribing accounting practices and procedures." The report of the special staff committee on accounting, issued February 28, 1938, recommended that financial statements not prepared in accordance with generally accepted accounting practices be deemed misleading despite disclosure. Further on, the committee introduced the concept of "substantial authoritative support." Both of these concepts were incorporated in the draft of ASR No. 4. Mathews must have been shocked by this turn of events, for when the Commission met on April 13 he was the only Commissioner present to record a negative vote. ASR No. 4 was released April 25, 1938.

One can only speculate why there was a separation of views between Blough and Mathews. Possibly Blough believed that the concept of full disclosure had to have certain limitations, while Mathews felt otherwise. In any case, Blough left the Commission to join Arthur Andersen & Co. shortly after ASR No. 4 was released. Mathews stayed with the Commission to the end of his

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*aFor further discussions on the personality and contributions of Carman G. Blough refer to the following articles in the Fall 1982 issue (Vol. 9, No. 2) of The Accounting Historians Journal: Richard A. Scott and Elizabeth G. Ward, "Carman G. Blough: His Personality and Formative Years," pp. 53-60; and William D. Cooper, "Carman G. Blough’s Contributions to Accounting: An Overview," pp. 61-67.
appointment before, ironically, joining Northern States Power Company as vice president and comptroller in 1940, a position he held until his death in 1946. Although he lost his debate with Douglas on ASR No. 4, Mathews was able to defuse any ideas the Commission had on establishing accounting rules and principles. Moreover, during the period Mathews was with the Commission many procedures and policies were begun that still exist today.

FOOTNOTES

2Skousen, p. 19.
4Cooper, p. 29.
6Mathews, letter to Butler.
7Burns and Coffman, pp. 3-9, 73.
10Mathews, "Regulation," p. 17.
11Cooper, Interview.
12Mathews, letter to Kohler.
13Mathews, letter to Kohler.
16Blough, Notation.
17Barr, p. 6.
18Rodell, p. 126.
20Cooper, Interview.
21Cooper, Telephone.
22Special Staff Committee on Accounting, Report.
23Securities and Exchange Commission, Meeting, April 13, 1938.

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TITHING AND INCOME MEASUREMENT

Abstract: This article shows that the concept of income measurement goes back at least to Biblical times. The institution of tithing is examined and is seen to imply a concept of income.

In a recent paper, Hagerman described several accounting concepts used in the Bible. He found that the Bible described, in general terms, the purposes of financial accounting, the rationale for internal control procedures and some ways to implement them, and examples of managerial accounting. Thus, many of the fundamental concepts of modern day accounting were known in Biblical times.

One concept not discussed by Hagerman is that of income determination. The purpose of this note is to describe the practice of tithing in the Bible and to show how this practice implies a concept of income. In particular, tithing requires a differentiation between income and capital.

Tithing—Old Testament

The word "tithe" means one-tenth. The custom of tithing was a common practice in antiquity and consisted of paying one-tenth of agricultural produce to the ruler of the temple. Since ancient societies were primarily based on agricultural economies, the tithe has been viewed by some scholars as a sort of income tax.

The Old Testament practice of tithing seems to have its roots in actions taken by Abraham, mentioned in Genesis 14:20, and by Jacob, mentioned in Genesis 28:22. After hearing that Lot had been captured, Abraham and his men attacked and routed Lot's captors. Abraham also obtained a large booty from the fight. From this Abraham paid a tithe to Melchizedek.

Genesis 14:20b: Then Abram gave him [Melchizedek] a tenth of everything.
In Hebrews 7:2-10, the word "everything" is explained to mean everything gained from the battle. Compare verse two with verse four.

Hebrews 7:2a: Abraham gave him a tenth of everything.  
Hebrews 7:4b: Abraham gave him a tenth of the plunder!

Jacob also practiced tithing. When Jacob fled to Laban from his brother Esau, he vowed to tithe if God would be with him.

Genesis 28:22b: Of all that you [God] gave me I will give you [God] a tenth.

The tithe was related to the offering of first fruits; it was a way to express gratitude for one's blessings,\(^4\) acknowledge God to be the source of all possessions.

There are three tithe laws in the Old Testament.\(^5\) In Leviticus 27:30-33 one is admonished to pay a tithe on his grain, fruit, herd, and flock. In Numbers 18:21-32 it is stated that the tithe is to be paid to the Levites. Finally, in Deuteronomy 14:22-29 it is explained that the tithe is, in part, to meet the needs of strangers, widows and orphans.

Many other Old Testament scriptures could be cited to illustrate tithing, for example, Deuteronomy 12:6, 11, 17-18; 26:12-15; II Chronicles 31:5-12; Nehemiah 10:37-39; 12:44; 13:5, 12; Amos 4:4; Malachi 3:8-10.

**Tithing—New Testament**

The early Christian church continued to support the idea of tithing. The central argument for the tithe was now that it provided financial support for the ministry;\(^6\) the church used scriptures such as Matthew 10:10; Luke 10:7; and I Corinthians 9:7 to bolster this proposition.

Interestingly, the early church fathers extended the tithe from a payment of one-tenth to the payment of at least one-tenth. Irenaeus, Cyprian, Origen, Chrysostom, Augustine, and Jerome urged Christians to pay at least a tithe.\(^7\) Their reasoning seems to be based on the Lord's saying that the righteousness of his disciples should exceed that of the scribes and Pharisees, who paid a tithe of their means.\(^8\)

Implications of Tithing

The custom of tithing has several implications. The first is that the Bible writers must have had distinct concepts of income and capital. While there is no direct reference on this point, Genesis 14:20, states that Abraham paid a tithe to Melchizedek on the booty he had obtained; the tithe is thus computed on a particular increment in Abraham's wealth. Since an increment of wealth is our concept of income, the inference is that the tithe was paid on Abraham's income. In Genesis 28:22, Jacob promises to pay a tithe on everything he gets from God, his wealth increment. Inasmuch as tithing is one-tenth of what one gets, a person is essentially contributing one-tenth of his income, not one-tenth of his capital. To determine how much to tithe, a man had to know his income.¹

The second implication is that the tithe was usually paid in kind. A tithe on grain was paid with grain; a tithe on cattle was paid with cattle. A potential problem of tithing in kind is that one might choose to tithe with inferior produce or animals. The solution appears to be sampling (Leviticus 27:33); that is, one should sample the increase in wealth and pay with a random sample of one-tenth. One could, however, "redeem" part of the tithe by paying the value plus one-fifth in silver or some other money (Leviticus 27:31; Deuteronomy 14:25). Presumably, value is current market value, although the term does not appear to be defined anywhere.

The Bible appears to use a concept of income. This concept of income is not described explicitly, but is implicit in scriptures concerned with tithing. Income was separate and distinct from capital, and based on a change of wealth concept.

FOOTNOTES

¹Hagerman, pp. 71-76.
³All Biblical references are from The Holy Bible: New International Version.
⁴Neusner, pp. 177-180.
⁵Kaufman, pp. 189-190; The International Standard Bible Encyclopaedia, pp. 2987-2988.
⁶Hastings, p. 348.
⁷Roundell, pp. 46-47; Vischer, pp. 13-17.
⁸Roundell, pp. 46-47.
⁹It is interesting that a number of writers compare tithing to income taxes. See, for example, Alexander and Alexander, p. 460; and New Catholic Encyclopedia, pp. 174-175.
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THE IDEAS OF STUART CHASE
ON WASTE AND INEFFICIENCY

Abstract: This paper discusses Stuart Chase and his thoughts on social accounting and the economics of waste and inefficiency. An evolutionary socialist, economist, and CPA, Chase saw waste as the major socioeconomic problem of our time, and argued that industry, the government, and the public could do much to overcome this problem. He suggested an optimal balance between **laissez-faire** and governmental regulation as a remedy for the inefficiencies of our economic system.

A Biographical Sketch

Born in 1888, Stuart Chase was educated at the Massachusetts Institute of Technology and Harvard University. His father, Harvey S. Chase, was instrumental in establishing the American Institute of Accountants and creating the first Uniform CPA Examination. Stuart Chase studied economics and became a CPA. He joined the Federal Trade Commission in 1917, where he investigated the meat packing industry. He was assigned to determine the cost of meat processing, but discovered that meat packers used such a variety of accounting methods that he could not adequately perform this assignment.\(^1\) In 1922, Chase helped organize the Labor Bureau, Inc., a nonprofit organization providing economic advice to unions and cooperatives, which examined the commercial working environment and promoted the utilization of efficient operating methods. As an accountant for the Labor Bureau, Chase “[helped] unions achieve higher wages for their employees and [helped] cooperatives manage their fiscal affairs.”\(^2\)

The author of many nontechnical books on socioeconomic problems. Chase was influenced by the writings of Henry George, Karl Marx, and Thorstein Veblen. A recurring theme linking a number of his books is the impact of technology on society. Other themes
appearing in his writings include waste in corporations and government, labor problems, and conservation of resources.

In the following discussion, we analyze the main ideas of Chase with respect to waste and inefficiency in the U. S. socioeconomic system and the effect Chase had on the accounting function.

He was among the first social accountants in the U. S., and raised many provocative questions about the economic and social objectives of business and government. He defined the goals of an economic system without:

... excessive waste and loss, whereby those who live under it may eat. It has the function to provide food, shelter, clothing, and comforts in as dependable and adequate quantities as natural resources and the state of the technical arts permit, just as the function of human physiology is to supply every cell with enough oxygen and nutriment.\(^3\)

In the early twentieth century, such views were heretical in this country. However, they have led to recent calls for corporate social accountability (particularly in the 1960s), largely ignored in the 1920s.\(^4\)

Chase pointed to limitations of economic theory. Referring to the profit motive:

... More important will be the problem of how to live; how to use fruitfully one's leisure time, how to improve the biological stock; how to educate, how to live and marry without the emotional miseries which now beset us; how to develop the arts; how to get the most out of life.\(^5\)

Once basic economic needs are satisfied, Chase contended, then society should be concerned with improving its way of life. Chase, however, recognized that few are concerned with the larger aspects of the economic system, and the contributions that their daily work can make.

What man starting in business, asks himself ... whether the work he proposes to do will strengthen or weaken the economic system; whether it will serve a social function; whether it will increase or decrease the evil effects of the business cycle; whether it will choke or expand the flow of
Bloom and Heymann: The Ideas of Stuart Chase on Waste and Inefficiency

purchasing power? Such questions are normally undreamed of, and are displaced by others. Is there money in the venture? Or is there any fun in it?

Chase argued for an ordered social framework:

Order, discipline, the consciousness of definite social aim are needed to insure a dependable flow of goods from the earth to the ultimate consumer. . . .

Chase’s Views on Waste

Chase was highly critical of the wastefulness inherent in a socioeconomic system. Chase defined waste as that which is unnecessary to society as a whole. All economic activities should be geared solely to produce food, shelter, and clothing “with a minimum of wear and tear and friction.” Waste is the measurement of how far society has failed to apply its own proven knowledge to the satisfaction of its wants.

The extent to which economic performance does not reflect human needs represents waste. According to Chase, waste can be determined by comparing present and ideal circumstances. Chase pointed to several instances of waste in modern societies, such as unemployment, excess plant capacity, and inadequate inventory control. He was particularly concerned with technological unemployment and consumer waste through ignorance, advertising, crime, drugs, quackery, speculation, and gambling. Because of such waste, there are significant losses of scarce natural resources.

Chase’s ideas on socioeconomic waste bear a striking resemblance to Berle’s, the latter asserting:

For a century the United States has been pioneering. We did not care whether it was dishonest, or whether the system was wasteful, or whether this group of investors got hooked, or that group made an inordinate profit or the stock market made or lost fortunes, or anything about it. So long as railroads got built and plant was there and our industrial system was made, we could afford almost any amount of waste, or even corruption in the process. Suddenly we got to the point where we had all the production we needed, we had all the plants we needed. Another railroad is not a service to the community, it is just a damn nuisance. At that time, as has always been true in history, it tightens up. You cannot afford to waste any
more. You cannot afford to graft any more. The importance of savings becomes tremendous, for the minute management fails, that minute savings are no longer safe.\textsuperscript{12}

Like Berle, who talked about "savings," Chase emphasized the importance of conservation of our resources to counteract wastefulness. Chase did not consider the importance of saving, investment, and economic growth until the 1930s, when he became influenced by Keynes' writings.\textsuperscript{13}

\textit{Measurement of Waste as a Social Role for Accountants}

Chase offered a thoughtful way of measuring waste and inefficiency under ideal circumstances, from a macroeconomic point of view:

Given a population, given its basic needs and wants, given the deposits of natural resources from which such needs may be supplied, given an industrial mechanism of production and distribution whereby natural resources may be turned into human requirements, given existing scientific knowledge, and all the factors are at hand to develop a standard for a coordinated industrial system which can really measure the problem of waste. Budget the basic wants; ascertain the raw materials available; survey the industrial plant in light of the present status of the technical arts, and calculate what it means in human effort to get these basic wants out of the earth and into people's lives with a minimum of effort and friction. Such a standard, it goes without saying, is based flatly on the assumption that an economic process has no justification other than that of supplying the things which mankind needs; that the only end of human work is to produce the groundwork for a rich and happy human life.\textsuperscript{14}

What Chase does not explicitly discuss in his writings is how the accounting function in particular may promote operational efficiency, by developing suitable information systems to detect and correct inefficiencies. Nowadays management accountants are concerned with establishing standards and identifying actions needed to correct operations that are out of control. Chase also influenced social accountants to be concerned with inefficiencies in addition to corporate and government stewardship to the public at large.

Attempting to interpret Chase's work in today's context, Chase might have said that social responsibility is closely related to the
objectives of providing information for both decision making and stewardship. A social goal is implicit in these two objectives. The most comprehensive form of stewardship is social—accountability to society at large. The traditional rationale behind disclosure of relevant information to users has been socioeconomic, i.e., to allocate resources efficiently. In recent years, federal, state, and local governments have taken steps to make firms more socially accountable. These measures included regulations or prohibitions, violations of which result in fines. Generally, however, the government has continued to absorb most of the cost of correcting the environmental problems caused by socially irresponsible firms.

If enterprises were required to account fully for the social effects of their actions, then investors and governmental agencies could better assess their activities. Chase, it appears, would have preferred to see governmental agencies assume a greater role in this regard, for the benefit of the public at large. In the last few years, objections have been raised increasingly against the idea of massive government intervention in lieu of *laissez-faire* in business enterprise. Indeed, currently there is a significant movement underway, in the business and governmental communities, to dismantle the limited apparatus created in former years by federal, state, and local governments to make business more socially responsible.

This approach to elimination of inefficiency is founded on the theoretical concept of perfect markets, which, in terms of Adam Smith's invisible-hand argument, serve to eliminate waste, and lead to a Pareto optimal economic system. Chase believed that Smith's invisible hand did not work in the real world, without adequate information and regulatory assistance. However, we see regulation becoming ensnared in bureaucratic inefficiency, thus adding to social costs.

*Chase's Impact on the Accounting Function*

Chase's broad view of the accounting function can be best understood by considering his discussion of the nature of prosperity, or wealth. Chase divided the concept into four distinct definitions:

First, the commercial or business meaning. This is by far the commonest, and is measurable primarily in corporate profits, stock market quotations, bank clearings, volume of trade, price levels, export business, commercial failures, and, to a lesser degree, in physical production of goods,
wage levels, volume of unemployment, national income per capital. . . .

Second, prosperity may be defined in terms of the distribution of material goods and services to the ultimate consumer. . . . This definition is more human than the first in that it casts a general glance in the direction of the material well-being of the wayfaring man, but it does not say much about the value of the goods, or their net effect on health, happiness, and habits. . . .

Third, prosperity may be defined as an economic condition in which even if business does not particularly boom, or the distribution of tangible goods seems particularly lavish, the average citizen enjoys security and a modicum of leisure. It registers an end to the economic fear of old age, sickness, accident, unemployment. . . .

Fourth . . ., we might define prosperity as the life more abundant—an alliance of definitions two and three—compounding security and leisure with a wide variety of useful and beautiful material things.15

Thus, Chase's concept of prosperity or wealth extends beyond the narrow definition used by accountants today. The accounting function has traditionally recognized private costs and private wealth in looking at the efficient utilization of economic resources. Chase's concept of prosperity included his views on the accounting concept of depreciation, and Chase's views on accounting for capital resources are instructive:

The chief internal source from which corporations draw for improvements in plant and equipment is their reserve for depreciation. What does depreciation mean as applied to a business concern? It means two things: actual physical wear and tear of buildings, machinery, furniture, and fixtures, and second, the record of these processes in dollars and cents on the company's books.16

Chase explained the concept of "depreciation."17

. . . For most things it is impossible to measure depreciation accurately. There are too many variables. But it is impossible not to recognize that it takes place. If a concern pays out all its earnings without making allowance for depreciation its directors may wake up some fine morning
with a junk pile on their hands, and instead of an operating plant, the sheriff striding briskly through the wreckage.

Chase indicated that depreciation used to be recorded unsystematically, contrary to the matching principle.¹⁸

Up to about the year 1900 most American business men admitted the fact of depreciation, but the way they recorded it on their books can only be described as temperamental. In a good year they might write off a million dollars for wear and tear; in a bad year, nothing. My father, Harvey S. Chase, was retained as a consulting engineer by various textile mills in New England in this period, to examine depreciation facts. He was shocked by the loose and casual way in which depreciation was accounted for. He advocated regular allowances every year whether profits were high or low. Manufacturers in turn were shocked by such a systematic wallop at their earnings.

According to Chase, the concept of conservatism underlies accounting depreciation, the latter being a process of cost allocation rather than valuation:¹⁹

The battle for systematic depreciation allowances has long since been won. The trouble is that it has been more than won. This is an interesting development, close to the heart of our story. I have already observed, and your common sense will confirm the statement, that the money cost of depreciation is almost impossible to determine accurately. Here, for instance, is an Empire State Building. Apart from the land it stands on, it cost, let us say, $100,000,000 to build. How long before it will fall down and become valueless except for junk? What will the junk—or salvage value—be worth when it does fall down? Neither of these questions can be answered except by astrologers. So the accountant must guess. He guesses that the building will last at least one hundred years. He guesses that the steel and other materials can be salvaged for $2,000,000. But now, as a good accountant, following the traditions of his profession, he must be conservative and qualify his guess. So he cuts down the life expectancy to sixty years, and the salvage value to $1,000,000. That surely will be safe enough.
Thus it is clear—and as an accountant for many years I had occasion to learn it—that while depreciation has been admirably systematized on the records, it is a long way from the physical facts. Meanwhile the records consistently and deliberately overstate the physical facts.

The conventions underlying financial accounting for capital resources (e.g., conservatism) make such data essentially useless for social valuations. Many of Chase's idealistic views with respect to accounting for waste and social wealth were restricted by accounting practice itself.

**Recapitulation**

To concisely sum up Chase's socioeconomic ideas on waste, the following quotation is most appropriate:

> If society made the things it genuinely needed according to the best available technical methods of production and distribution there would result an industrially wasteless society. Such a social group may never completely eventuate; but it constitutes the standing challenge to the intelligence of mankind. It is more than time that the challenge be taken up to the point at least of compiling a rough engineering draft of a wasteless society, and of estimating the vast increase in well-being which would accrue if society had the common sense to plan for its own provisioning.

Such a draft is not capitalism, socialism, nor any other ism. Its philosophy cuts sharply across all doctrines of opinion and concerns itself only with the facts. It is inevitable unless society is willing to proceed to its own destruction with its national, class, race, group conflicts (from war down to "legitimate" business competition), all internecine as far as humanity is concerned, and in themselves the apotheosis of waste.

Some might infer from the foregoing that Chase was a revolutionary socialist. This is not so. Chase considered waste to be the major socioeconomic problem of our time and argued that industry, the government, and the public could do much to overcome this problem. As an evolutionary socialist, Chase suggested that an optimal balance between *laissez-faire* and governmental regulation was needed to remedy the inefficiencies of our economic
system. He favored an organized economy, and was not content to allow the "market mechanism" to have free reign.

Chase's contributions were numerous and varied. He popularized the subject of economics, making it simple for lay readers to understand. An investigator of perennial socioeconomic problems, Chase was especially critical of the unmanaged nature of our economy, the unnecessary depletion of our national resources, technological unemployment, and socioeconomic irresponsibility in general. His views are timely today especially since he appeared to espouse the idea that the future would not necessarily be brighter than the past; the notion that progress is generally beneficial appears to be passé today.

FOOTNOTES

2 Lanier, p. 44.
3 Chase, A New Deal, 1932, pp. 22-23.
4 Previts and Merino, A History of Accounting in America, p. 201.
5 Chase, 1932, p. 23.
6 Chase, 1932, p. 4.
7 Chase, 1932, p. 23.
10 Chase, 1921, p. 284.
11 Chase, Men and Machines, 1929, p. 334.
12 Berle, "Responsibility for Presenting True Condition of the Corporation to the Public," p. 11.
13 Lanier, pp. 87-88.
14 Chase, 1921, p. 284.
15 Chase, Prosperity—Fact or Myth, 1929, pp. 25-26.
17 Chase, 1940, p. 227.
18 Chase, 1940, p. 227.
19 Chase, 1940, p. 228.
20 Chase, 1929, p. 232.

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Reviewed by
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The *Encyclopaedia of Accounting* (*Encyclopaedia*), edited by George Lisle, consisted of six volumes published in 1903 and 1904 by William Green and Sons of Edinburgh, Scotland. They contain “two hundred principal articles and many more minor notes on a variety of subjects in accounting and related fields of interest” (*Preface*).

Seventeen of the principal articles in the *Encyclopaedia* have been reprinted in *Selections from Encyclopaedia of Accounting 1903*, edited by Richard P. Brief. In addition, the first section of this book consists of reprints of the book reviews of the *Encyclopaedia* that appeared in *The Accountant's Magazine* shortly after each of the six volumes was published. These reviews are helpful in evaluating the *Encyclopaedia*, which Professor Brief refers to as the “first handbook of accounting” (*Preface*).

The second section presents the selected articles, which deal primarily with accounting history, financial accounting, and cost accounting. The content of each is summarized below.

1. “Accountant” by Richard Brown (6 pages) is a history of the growth of the accounting profession in Scotland.
2. “Accountants Abroad” by Th. Limperg, Jr., (3 pages) discusses the development of the accounting profession in The Netherlands.
3. “Accounting in Its Relation to Economics” by Victor V. Bradford (27 pages) discusses the relationship of accountancy to economics in regard to value.
4. "Auditing" by Lawrence R. Dicksee (31 pages) discusses the general principles of auditing, the duties and responsibilities of auditors, and the legal position of auditors.
5. "Averages" by Arthur L. Bowley (8 pages) is a quantitative article describing the nature and use of averages.
6. "Balance Sheets" by George Lisle (14 pages) discusses the nature of the balance sheet and the illustrated arrangement of items on the balance sheet.
8. "Book-keeping: Literature" by Richard Brown (3 pages) provides a comprehensive list of books on bookkeeping. The list includes the title of every book he could locate written in European languages through the 17th century; thereafter, only books written in English are included.
9. "Book-keeping: Its Adaptability to the Requirements of Every Class of Undertaking" by Lawrence R. Dicksee (6 pages) supports double-entry bookkeeping by explaining how every conceivable class of business transactions can be recorded according to the rules of double-entry bookkeeping.
10. "Cost Records or Factory Accounting" by John Mann, Jr., (40 pages) discusses the advantages of good cost-keeping and the essential characteristics that all systems of cost accounts should include. Examples of various systems and the related forms are presented.
11. "Depreciation" by Edwin Guthrie (20 pages) discusses various aspects of depreciation with emphasis on determining the proper charges for depreciation.
12. "Diagrams" by Arthur L. Bowley (11 pages) explains, with accompanying illustrations, how diagrams can be used to present information effectively.
13. "Factory Organisation and Costing Arrangements" by Cossar Mackenzie (16 pages) deals with designing a system of cost accounts to provide useful information about the enterprise.
14. "Foreign Currencies and Their Treatment in Home Accounts" by George Lisle (9 pages), discusses some of the principles of foreign currency translations.
15. "On-costs or Expenses" by John Mann, Jr., (27 pages). "On-costs" are defined as "all the elements in a product which do not fall under productive labour, materials, or profit" (p. 199, irregular). Mann elaborates on how these costs are ascertained, classified, and allocated.
16. "Reserves and Reserve Funds" by Sidney S. Dawson (7 pages) explains the various usages of the term "reserve."
17. "Stocks and Stocktaking" by John A. Walbank (16 pages) discusses various aspects of taking and valuing an inventory.

A list of the authors of the principal articles that appeared in Volumes I-VI of the Encyclopaedia comprises the third and last section.

This book provides an insight into accounting in Great Britain around the turn of the century.


Reviewed by
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Using a historical framework, this book provides a critical analysis of the international development of concepts on accounting in an inflationary environment. The author argues that the historical development of price-level accounting ideas disregarded "the contexts in which they first arose . . . [and] the specific purposes they were intended to serve" (p. xiii). Clarke contends that the concepts of accounting under inflationary conditions have been haphazardly recycled over time in an unproductive manner.

Specifically, he offers the following criticisms of the drift of ideas about inflation into accounting (pp. 1-2):

- the inconsistencies between accounting concepts and economic theory—e.g., income;
- the emphasis in much of the literature on consideration of either general price-level changes or specific price changes as a complete solution to the problem of accounting for inflation; and
- the indiscriminate transplantation of ideas on replacement costing from the context of utility-rate setting to financial reporting.

The book consists of four parts. Part 1 provides general background material on the principal issues analyzed in the book. Part 2 deals with the evolutionary development of accounting for changes in the general price level; Part 3 with changes in specific prices;
and Part 4 considers combinations of general and specific price changes.

The historical development of ideas on accounting for inflation is perceptively investigated on the basis of issues rather than using a simple chronological approach. For example, in considering the evolution of accounting thought on general price-level accounting, Clarke provides a comprehensive analysis of Middleditch's work. Contrary to many authors, Clarke emphasizes the fact that Sweeney was not only in favor of general price-level accounting but also specific price accounting. The author observes that before the period from 1963 to 1980, voluntary corporate indexation of accounts to reflect general price-level changes was "undisciplined and uncoordinated," largely the result of income tax considerations.

Particular emphasis is placed in this study on the "accidental" drift of ideas into accounting from other sources without meticulous examination of their suitability. As a case in point, the author maintains that the use of "fair values" in utility rate regulation necessitated the consideration of both factual and speculative data regarding past and future revenues and expenses, whereas the transplantation of this concept to accounting failed to consider its "illusory nature" (p. 31). Clarke asserts that (p. 191):

Replacement prices and reproduction costs were treated as if they were indicative of the actual monetary worths of ordinary companies' physical assets, even though no similar indications had been implied in the rate cases.

According to Clarke, accounting for general price-level changes emerged as an outgrowth of the international need to stabilize currencies following World War I. Emphasis was placed on general purchasing power losses from holding liquid assets during an inflationary period. Clarke argues that this experience may be the source of the well-entrenched, erroneous idea that holding physical, nonmonetary assets during an inflationary period precludes the incidence of general purchasing power gains and losses. In his words (p. 68):

Who gains and who loses general purchasing power during inflation depends not only on the amount of actual money each entity holds or owes, but also on whether the prices for which their vendible physical assets can be sold increase or decrease at a faster or slower rate than the rate of change in the general level of prices.
The author argues that there has been considerable advocacy of current replacement cost accounting as a surrogate model for discounted cash flows—not for its own relevance (p. 242). Also, Clarke asserts that Hicks' definition of income has been largely misused in accounting literature on price-level accounting relying on his ex ante rather than his ex post concept.

Clarke observes that Bonbright's concept of "value to the owner" stemmed from a judicial opinion on the compensation to be paid those who lost property. Indemnification, says Clarke, does not apply to companies that are not deprived of their assets (p. 258). He also observes that current cost accounting skirts the issue of technological change (p. 292):

> . . . various prescriptions have tried to nullify the effects of changing technology with explanations of replacement, in terms of modern equivalent assets.

From chapter to chapter, Clarke's views are forthright, if not iconoclastic. Contrary to popular belief, he argues that Edwards and Bell provide nothing essentially new. As an example, he asserts that "holding gains," with which Edwards and Bell are often associated, were introduced into the accounting literature well before their 1961 book.

Critical of gearing and monetary working capital adjustments, which are required for disclosure by some pronouncements on accounting for price-level changes, Clarke contends that (p. 410):

> The addition of 'gearing' . . . and 'monetary working capital' . . . adjustments merely accentuates the existing problems with the CCA [current cost accounting] mechanism. The former introduced a notion of capital gearing generally conflicting with that normally used in financial analysis; implied specific financing patterns, for which no empirical support was produced; and implied (and sometimes specified) that the gearing ratio and financing patterns were constant over time, contrary to the observable adaptive behavior of corporations.

Finally, Clarke believes that none of the pronouncements on accounting for changing prices which were issued prior to publication of this study furnishes "a serviceable method of incorporating the financial effects of price and price-level variation" (p. 421).

This detailed study, originally the author's Ph.D. thesis at the University of Sydney, is carefully-researched and well-documented.
However, the current U.S. and U.K. pronouncements on accounting for changing prices are inadequately examined and sketchily treated. The Dutch contributions to current replacement cost accounting and Chambers' exit value accounting model are both given short shrift. All in all, the book captures the profound confusion that has long prevailed in this subject area. A critical study, it is provocative and stimulating, shattering many widely held beliefs. Clarke's study provides a fresh perspective, and is highly-recommended reading, on the history of accounting for price changes.


Reviewed by
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Frank Sewell Bray was a unique blend of practical accountant and academic. To many of the current generation of professionals, his "Design of Accounts," written in collaboration with Basil Sheasby, was a landmark of understanding; and accountants looked with eager anticipation for the books that followed it.

This work traces the development of Bray's thinking and writing, not only in his eight books published between 1944 and 1957, but also his contributions to professional journals. R. H. Parker examines his developing views on the relationship of economics and accounting, his approach to inflation accounting, and his place among academics, and tributes from such eminent contributors as Professor Chambers, Ian Hay Davison, James Risk, and Louis Goldberg are included with a very excellent compilation of works by Bray himself. These last cover published writings within the period described above, a number of them from Accounting Research, a journal sponsored by the Society of Incorporated Accountants that died on the integration of members of that body into the Institutes of Chartered Accountants. Editorship of this magazine, possibly ahead of its time in the U.K., and being Stamp-Martin Professor at Incorporated Accountants' Hall were challenging and fulfilling tasks, and the profession in England was poorer for their disappearance. Bray himself was bitterly disappointed and many people, both within the profession and without, shared that keen sense of disappointment and disenchantment.
From the description of his life, his practical work as a busy partner in a growing practice, his sincerely-held religious views, his work for the community, and from the representative selection from his writings, the reader begins to see a picture of the man himself. He was criticised by some as guilty of tautology in his style of writing. But he was a catalyst to many whose thoughts were turning to new methods of reporting income, to economic bases of judgment, cash flow significance and the presentation of balance sheets in meaningful terms. He wrote with Basil Sheasby, C. V. Dawe, Richard Stone (in books on a wide variety of subjects) and partnered Leo Little in the editorship of Accounting Research. His influence on his profession, in the end, was greater than he perhaps knew himself. There are, indeed, areas where his ideas (e.g., on the overriding importance of National Accounts) have not been received into mainstream philosophy, but even there, one must believe that the theory has not been without some influence in the development of accounting thought.

This book is a fascinating reflection of a man and of a time. As so often in life, they met because they were needed. The pebble dropped in a deep well does spread its ripples over the water even if one cannot see them clearly.


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Museum curators must find it easier to attract and retain our attention than writers of accounting history. They will please most of us by displaying the remains of some prehistoric animal (preferably from the other side of the world) that has had the good fortune to be preserved in ice or stone for millions of years. Few of us stop to think that the focus of our attention was, in its time, neither unusual nor unique. It just happened to be on the spot when a sudden change in conditions preserved its mortal remains for all time.

Would that the accounting historian were so lucky. In addition to a description of the subject, he needs to help us with an understanding of the events that he is describing. Goldberg does just
that. In *The Florescent Decade*, he paints a picture of accounting education in Australia in the years 1945 to 1955. He draws on many sources of original evidence to show the importance of individuals, professional associations, and tertiary institutions in this period.

The development of accounting education in the Australian universities and technical colleges is traced from its beginnings. The importance of the technical colleges is mentioned, but the subjects most closely examined by Goldberg are the influence of the Commonwealth Institute of Accountants (which merged with the Federal Institute of Accountants and the Association of Accountants in Australia to form the Australian Society of Accountants in 1952); the University of Melbourne; and the brothers A. A. and G. E. Fitzgerald.

In the period between the wars there was slow but discernible progress in moving accountancy studies to a level where they would be not only a recognised entree to the profession, but also acceptable as a discipline at university level. Yet until 1945 there were no full-time staff teaching accountancy in Australian universities or technical colleges. The first full-time appointments included Goldberg in 1945, Jean Kerr and Stewart in 1946 (University of Melbourne); Braddock (South Australian School of Mines) and Keown (Melbourne Technical College) in 1946; Chambers (University of Sydney) and Mathews (University of Adelaide) in 1952; Smyth (University of New South Wales) and Nichols (University of Tasmania) in 1955; and Gynther (University of Queensland) in 1959.

These appointments were associated with a substantial increase in enrolments in the accountancy subjects offered in commerce courses. For example, in 1945 there were 139 students enrolled in Accountancy 1 at the University of Melbourne. By 1947 their number had increased to 647.

Many of the students were ex-servicemen who were assisted by the Commonwealth Reconstruction Training Scheme to take up tertiary studies. The scheme made available educational courses to those who had postponed their studies because of the war. More importantly, it provided an opportunity to many who in pre-war conditions would have been unable even to contemplate university or other post-secondary study.

The demand for education could be converted to a need for accountancy education because of the groundwork that had been done in the universities (especially Melbourne, Adelaide, Sydney and Tasmania) and technical colleges (particularly Melbourne Technical College and the South Australian School of Mines) before 1939.
As well as this foundation in the tertiary institutions there was the expectation by the Commonwealth Institute of Accountants that it would vacate the examination field when the universities and colleges were able to demonstrate that graduates from their courses could meet the educational requirements for professional membership. Goldberg documents no less than six references to this long-standing attitude of the Commonwealth Institute. Its descendant, the Australian Society of Accountants, ultimately began to phase out its own examination system in 1967.

Goldberg draws attention to three threads that ran through the development of accounting education in Australia. There was the role played by the University of Melbourne with its long-established commerce course and its pioneering role in the teaching of accountancy in Australian universities. Second was the influence of the Commonwealth Institute of Accountants, numerically the largest of the professional accounting bodies (with its headquarters in Melbourne), which clearly recognised that the profession would be best served if the teaching and examining of potential members was left to the universities and colleges. The third, and in many ways the most significant influence was that of A. A. and G. E. Fitzgerald. Both were deeply involved with the activities of the Commonwealth Institute of Accountants and the teaching of accounting at the University of Melbourne.

Goldberg makes it clear that the pattern of Australian accounting education would have been very much different, and its progress not nearly so rapid nor successful, but for the influence of the Fitzgeralds and these two organisations into which much of their professional endeavour was channelled. The importance of the Fitzgeralds has been documented elsewhere. It would be hard to overstate their importance to the development of accounting and accounting education in Australia.

Professor Emeritus Goldberg has given us a book that will interest all accounting educators. It is prescribed reading for any accounting educator visiting Australia. Those whose formative years were spent in Australia will also find much in it that will provide them with a better understanding of the current Australian accounting education scene.

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Reviewed by
M. J. Mepham
Heriot Watt University, Edinburgh

This well written study of the development of the British side of Ernst and Whinney is an unconventional house history in that it deals with its subject matter within the context of the evolution of the UK accountancy profession. This approach means that the book begins long before Frederick Whinney joined the London firm of Harding and Pullein in 1849 or the opening of Ernst and Ernst's office in New York in 1918.

Chapter One briefly notes the 14th century origins of the double entry system and its initial emphasis on the prevention of dishonesty and negligence rather than on the measurement of profitability and the provision of economic advice. The slow progress of the system over the ensuing 500 years is mentioned, but the author moves rapidly to the development of the UK accountancy profession. Jones considers that this development is inextricably linked with the history of the Industrial Revolution and he identifies the 1840's as the critical decade.

The Bankruptcy Act of 1831, the 1844 Companies Act, the subsequent growth in the formation of companies, the development of the railways, the gradual recognition of the need for accounting controls when business drew its capital from the general public, all created a demand for the services of accountants. The 1840s saw the establishment of accountancy practices whose names are prominent in a roll call of the large firms; and five of Ernst and Whinney's predecessor firms were also founded in this period.

Whinney, Smith and Whinney developed from one of these practices (Harding and Pullein), and the book provides some interesting insights into the sources of this firm's fee income over the last half of the 19th century. Insolvency work provided 73% of the income in 1848, this rose to 94% in 1865 but slumped to 20% by 1900. In contrast, auditing provided a meager 2.4% in 1860, but this had swollen to 53% by 1900. The claim that British accountants prospered in times of adversity because of their insolvency work was not so true by the end of the Victorian period as it had been at the beginning. The author points out that auditing did not feature in
the lists of an accountant's duties contained in the Edinburgh and Glasgow petitions for Royal Charters in the 1850's but that it was clearly included, some 25 years later, in the English Institute's charter.

The Edwardian period saw the formation of more of the founder firms of the future Ernst and Whinney, and also the beginnings of taxation as a new area of work for the profession. Pitt had switched from customs and excise to income tax as the main source of the national revenue; but in the 1840s, the income tax rate was a very low 2.9% and the collection procedures were simple. By 1900 the state had begun to recognise the need to redress some obvious social injustices, and because more revenue was needed, the income tax rate correspondingly increased. The Boer War caused another jump and the standard rate rose steadily throughout the 1914-18 World War. The inter-war period saw the accountant becoming more heavily involved with tax work, but it was not until World War II that this work began to generate a substantial fee income. Whinney Murray's tax department is the oldest and largest of the firm's specialist departments.

A fairly recent addition to the range of specialist services offered by professional firms is that of "management services." Cost and management accounting were late starters in the UK. Costing had lagged far behind the engineering and financial accounting developments of the Industrial Revolution and it was the 1914-18 war that first brought the subject into prominence when a number of senior accountants were drafted into government work. World War II brought further advances. The author's concentration on the history and contribution of professional firms leads to some incompleteness in his coverage of recent progress. There are, for example, only two brief references to the Institute of Cost and Management Accountants although this organisation must be recognised as an important factor in the development of management accounting in the UK.

The inter-war period saw a wave of business mergers, the growth of the holding company, and the beginning of consolidated accounts. The 1960s and 70s was another period of intense merger activity, with a decline (by almost 50%) in the number of UK public companies between 1948 and 1978. There was a corresponding increase in the average number of plants operated by the largest companies and in the extent of diversification and divisionalisation. This trend was accompanied by a significant migration of accoun-
tants into business, and also led to a number of major accountancy amalgamations.

In the last decade, a significant percentage of medium sized UK practices has been absorbed by the large firms so that the practising side of the profession is now polarised, with a large number of small practices and a very few very large firms. The largest of these have become as international as their larger clients. Jones describes these and other developments down to 1980 in his concluding chapter.

The book is an interesting and readable socio-economic history of the UK profession and of the UK side of Ernst and Whinney, but its unusual format does mean that some branches of accounting (notably management accounting and public sector accounting) and some important professional bodies are inadequately covered. Apart from this, the book is highly recommended. Economic historians have tended to regard the growth of financial services (including accounting) as relatively unimportant, in comparison with production, in that such services are not considered to create wealth. Edgar Jones has sought to remove some of these misconceptions and to show the nature and importance of the growth of accountancy to the British economy.


Reviewed by
Dale L. Flesher
University of Mississippi

There may be some question in readers’ minds as to why an accounting theory textbook is being reviewed in a history journal. Actually, the answer is quite simple; this particular theory book has substantial historical content. As with many accounting theory books, history is a major part of chapter 1 as the author included discussions of such factors as the industrial revolution, the nineteenth century railroads, the growth of the accounting profession, the early role of income tax laws and the impact of World Wars I and II. Managerial accounting is not neglected as the development of that field of study is also highlighted in the opening chapter.

Chapter 2 is even more historically oriented than the first, as the early history of accounting is explored. In addition to the contri-
butions of Pacioli, other topics covered include the early Byzantine and Babylonian periods, the role of the English Companies Acts and the theories of Sombart. Early contributions of various European accounting theorists are also highlighted. Indeed, the author’s penchant for international accounting shows through in his selection of accounting history topics.

Unlike most accounting theory textbooks, this book does not limit the inclusion of accounting history to only the opening chapters. In fact, virtually every chapter includes a historical discussion of the particular topic being covered. For instance, inflation accounting is discussed from the perspective of Henry Sweeney, the balance sheet chapter begins with the contributions of Charles Sprague, and the funds statement material starts in the 1860's.

The author obviously believes that the key to understanding accounting theory is based on an ability to understand why changes in accounting occur. Accounting students who only understand the status quo with respect to accounting theory will be limited when current theory changes. However, the person who can understand why theory developed in the past will be able to extrapolate that understanding to cover future changes. Most’s text gives students the historical why behind various aspects of accounting theory.

This reviewer has not attempted to evaluate all of the advantages and disadvantages of Accounting Theory (second edition). Instead, the use of accounting history to teach theory has been emphasized. The Most book fulfills the desire of many historians who want accounting history to be included in an accounting theory textbook.


Reviewed by
William G. Mister
Texas A&M University

Accounting Theory by Harry Norris is an Arno Press reprint of the 1946 edition, with a new preface by the author. The new preface serves as a good self review of the original work published over thirty years ago. In it, the author notes that an issue of current interest—accounting for rising prices—was “skated over” in the book. It would have been interesting to know the author’s current
views on this issue. In the book he firmly rejects the concept of a balance sheet as a collection of valuation accounts. Consistent with his earlier work, Norris would probably favor a constant dollar approach over a current value approach.

The book was intended to develop a needed, but non-existent theoretical structure of accounting. The practice of accounting grew in a haphazard, piecemeal manner. As practical problems arose they were resolved in a pragmatic fashion by consensus and compromise. The author felt, and still feels, that without the benefit of solid, received principles, accounting practice will continue to suffer. He notes in the new preface that in the thirty years since publication "not much has changed—certainly not enough!"

Norris takes a normative approach to developing accounting theory. He declares, "It is possible to derive 'first principles' by a process of reasoning more or less abstractly, and then to compare existing usage in accountancy with a theoretical ideal."

The main theme of the book, similar to Paton and Littleton's monograph, is the necessity of matching costs with revenues. Norris begins by developing a "theory of profits." The rules for ascertaining profit are: (1) profit arises when a sale is made; and (2) profit is to be computed by apportioning cost to related revenue. These rules are indicative of the conservative approach taken throughout the book.

Norris was an early advocate of direct costing. He argues that expenditures for the formation of future services to be rendered to customers should be carried forward as unexpired values of "some kind." Expenditures incurred which do not vary with the amount produced during the accounting period should not be attached to the physical stock of products. He maintains that "such a method of computation is correct only for expenses like 'raw materials' and 'productive labour' which vary directly with physical production."

Norris's concept of a balance sheet is one of residual balances. The balance sheet is not a classification of valuations, rather, it is a classification of "expenditures" according to the benefits accruing to the next or later accounting periods. The example of a balance sheet has four asset classifications, (1) capital expenditures (capacity expenditures); (2) production expenditures (inventories at prime cost); (3) expenditures on accruing rights (e.g., insurance); and (4) publicity expenditure. While this idea of a balance sheet does not agree with the current movement toward more valuation, the classification scheme is interesting. Leases, for instance, which do not fit well in present balance sheet classifications, would be
either a "capital expenditure" or an "expenditure accruing rights" depending on the nature of the lease.

In rejecting the concept of goodwill the author gives a rare glimpse at his ability to write in an interesting style. "If X is a live pedigree dog and Y a dead one, then perhaps X — Y = Z. But Z means nothing in itself. The label "goodwill" in business accounts closely resembles Z: its use is as sensible as trying to find what makes the dog tick by dissecting it."

I found the intertwining of the author's proposed "theory" with his description and analysis of then existing practice to be, at times confusing. To distinguish between what was being advocated and what were rationalizations of practice required careful reading.

Norris provokes much thought in Accounting Theory. The book documents an early plea for a solid foundation of theory upon which the practice of accounting can be built. These plans, though often repeated, as yet are unanswered. In my opinion, the reprinting of this book was a worthwhile undertaking.


Reviewed by
Stephen E. Loeb
University of Maryland

This book is a scholarly analysis of the life of an individual—James M. Landis—who seems to have had a remarkable effect on the regulatory process of the United States federal government. As a biography, it was carefully researched, documented, and written in clear and lively fashion.

In the first chapter "A Demand for Excellence" the author carefully describes the early life of Mr. Landis and emphasizes his family's demands for excellence. In the second chapter the author describes Landis' law school experience and his exposure to Professor (later Justice) Frankfurter. Upon graduation from Harvard Law School, Landis did graduate work under Frankfurter and then became a law clerk to Justice Brandeis. The author points out that it was through Landis' work with Brandeis that Landis developed an interest in federal regulation.

In Chapter 3 the author discusses Landis' experience as a professor at Harvard Law School. This chapter has some interesting
comments on the development of legal education in the United States, and especially at Harvard, during the 1920s. On page 33 there are some comments relating to academic independence and academic freedom.

In Chapter 4 the author covers Landis' influence on the drafting of Federal Securities Acts and the writing and enactment of these laws. Included is a fascinating glimpse of the politics of their drafting and passage. The chapter also mentions Landis' appointments to the Federal Trade Commission and to the Securities and Exchange Commission (SEC).

Chapter 5 contains an excellent discussion of the beginnings of the SEC and Landis' association with Joseph P. Kennedy. In 1935 Landis became SEC Chairman and the chapter deals with his work as Chairman, and his personal life in Washington. Eventually, Landis resigned to return to Harvard as Law School Dean. Chapter 6 contains a fascinating description of the events that led to Landis' appointment as Dean. The chapter also discusses some of Landis' theories of what a regulator should do.

Chapter 7 discusses Landis as a "trouble shooter" for the Roosevelt administration. Chapter 8 outlines Landis' activities during World War II and provides an interesting picture of official Washington at the time. Landis was Director of the Office of Civilian Defense, and later became an administrator on economic affairs for matters relating to the Middle East—a post that took him to that part of the world. Chapter 9 describes his experiences in this assignment.

Chapter 10 details his departure from government service in 1945 to assume again the Deanship at Harvard. It was a time of personal problems for Landis. He resigned from Harvard in 1946 to become chairman of the Civil Aeronautics Board (CAB). Chapter 11 describes his Chairmanship of the CAB, which he later left to work for Joseph Kennedy, and Chapter 12 continues with this period of his life, in which he also worked in private law practice. The chapter contains a detailed description of Landis' work as an advisor to John F. Kennedy. Chapter 13 notes that when Kennedy became President he asked Landis to make a study of the regulatory commissions, and to serve him as a special assistant. This chapter and the next mention Landis' personal and legal problems.

The book contains a fascinating and detailed biography of a remarkable individual who apparently had a marked effect on the federal regulatory processes in the United States.

Reviewed by
Lamont F. Steedle
James Madison University

*Cost Accounting and Burden Application* by Clinton H. Scovell is an appropriate choice for the Arno Press collection, *Dimensions of Accounting Theory and Practice*. Scovell’s work is a description of the principles and techniques of cost accounting, vintage 1916. Viewing his thoughts and insights from a modern cost accounting perspective shows him to have been well ahead of his time.

Scovell was a Harvard-educated CPA who lectured at Boston University and also had a private consulting practice. His discussions and recommendations are liberally sprinkled with examples, giving the reader not only evidence of his varied experience but also details of specific industrial products and processes of his time.

Scovell opens by recounting the history of the need for sound cost accounting methods. The birth of scientific management and organization of labor led to the need for unit cost data, because managers were involved in price competition and in cost reduction programs without full knowledge of product costs. Scovell’s stated purpose was to examine the elements of cost, define the principles of cost accounting and describe the methods of procedure in developing a cost accounting practice. His emphasis, by design, was on the determination and application of overhead charges. He justified the need for these methods, reasoning that as industry became more complex, more sophisticated methods were required to minimize the manager’s risk of loss.

The work covers in great detail the development of a sound cost accounting system. Separate chapters are devoted to defining the elements of cost, examining materials costs in depth, and reviewing job-order accounting for labor costs. Nine chapters deal with overhead costs, with much attention devoted to discussing the individual elements of overhead. Four later chapters apply many of these specific methods to unique problems in the foundry, textile, candy, and paper manufacturing industries.

In developing the section on overhead, Scovell appears to focus on capital intensive businesses. A discussion of overhead rates favors machine rates for overhead application in preference to
other approaches. When considering the determination, analysis, and assignment of specific overhead items to production centers, he devotes more attention to expense items closely related to equipment and its maintenance and operation.

Included in this section of the work is a provocative chapter on the capitalization of interest. Scovell argues for its inclusion in overhead, citing many practical examples for its utility. He also includes an appendix with numerous economic references that support its theoretical soundness. This material, which also covers selection of capitalization rates and the bookkeeping procedures for charging interest to cost, could be read independently of the remainder of the work.

After reviewing the assignment of overhead costs to production centers, Scovell discusses the determination and use of standard running time, or activity, and the computation, use and interpretation of unearned burden, today’s volume variance. Because Scovell recommends using practically attainable capacity for activity, his variance measures unused capacity. He then provides a very convincing argument for the separation of unearned burden from all other overhead charges, including any variance between budgeted and actual overhead, and for its treatment as a period expense. His point is that every manufacturing plant incurs overhead to maintain a certain production capacity and that these overhead charges must be distributed over that same production capacity. He further argues that only with the use of this approach will the influence of varying production on costs be removed, so that costs will change with manufacturing efficiency rather than with changes in production volume.

The remainder of the work discusses the budgeting system, the preparation of financial statements, and the relationship between cost accounting and general accounting records. Scovell stresses the importance of cost behavior in preparing budgets, the timely preparation of reports, and the integration of cost accounting data into the general accounting records to facilitate pricing and production decisions.

Current cost accounting procedures have become more sophisticated, the body of knowledge has expanded through the influence of other related areas and almost seventy years have passed. Still, much of what Clinton Scovell wrote has considerable relevance today.

Reviewed by
Yoshiro Kimizuka
Denkitsushin University

In Japan, where double-entry bookkeeping is only a century old, it is natural that studies in accounting history focus on other countries, primarily European. As long as they are concerned only with discovery of new facts, however, they do not deserve to be called scientific, though they may be a prelude to scientific research.

The volume under review is a challenging book that describes the logic, or theoretical schema, underlying the development of profit and loss accounting (hereinafter called "income accounting") in the eighteenth century English-language accounting literature. The first part, consisting of six chapters, is entitled "Growth of periodic income accounting" and is devoted to theory; the second part, entitled "Development of modern bookkeeping methods in Great Britain" traces the evolution of income accounting by analyzing typical textbooks, in an attempt to verify the theory. The first part is therefore more appealing to us.

The first chapter, "Historical schemata of development of income accounting," fascinates by revealing the author's original thinking. He reexamines the popular idea that regular, or periodic, income accounting developed from profit measurements for individual merchandise or venture accounts. According to Watanabe, the latter developed into control, or "general merchandise" accounts, quite separate from the total (lifetime) income which sums all calculated incomes from the firm's cradle to its grave, as it were. Moreover, total income includes all regular and special closings, and regular closings can be further subdivided into annual closings and those of other periods.

Until the fifteenth century, the basis for calculating income was the "balance," based on an inventory in the case of small, family businesses; partnerships could be liquidated at the end of the contract period of two to five years. A balance was more reliable because the complicated weights and measures of the time produced inaccuracies in the accounts. The books were closed in order to transfer the accounts to new books, or to liquidate after the merchant's death.
Thus, the author proposes a new concept that could be called “pioneer income accounting,” a transitional form that connects the individual merchandise or venture accounts to period or annual income accounting. It implies that (1) merchants were concerned more with total profits than with the profit on each individual article of trade, (2) this was not calculated periodically, and (3) income was determined on the withdrawal of a partner, or on liquidation, but the balance of the profit and loss account was not posted to the capital, or equity, account. In short, Watanabe’s schema is: non-period income accounting → a periodic income accounting → period income accounting.

In the second chapter, “Early form of periodic income accounting,” this viewpoint is verified by examining the works of Pacioli and Ympyn, and Italian conventions in respect of closings. Ympyn showed how to post the balance of the profit and loss account to the capital account, and may have initiated this practice. Chapter three, “Establishment of periodic income accounting” is discussed against the background of the shifting of international markets from Antwerp to Amsterdam. Trading was done through the medium of the “going concern” as corporations appeared on the scene. But worksheets were used for accuracy in closing the books, and annual income accounting was not practiced generally.

The fourth chapter, “Formation of general merchandise accounts,” shows the introduction of a “sundry merchandise” account for a variety of individually insignificant articles, and then the emergence of a “general merchandise” account to simplify record-keeping. The trial balance appears to have originated in the latter part of the eighteenth century, according to the fifth chapter, “Appearance of the trial balance.” During that century, medieval bookkeeping was transformed into modern bookkeeping. Work sheets evolved to find period income and prove the correctness of closing accounts, discussed in the sixth chapter, “Germination of work sheets.”

The second part of the book describes the texts by Malcolm, Mair, Weston, and Hamilton. The author emphasizes the Scottish contribution to the industrial revolution and many other fields, including bookkeeping. A bibliography of books from Hugh Oldcastle (1543) to Henry Tuck (1843) is appended, providing valuable information for students.

This reviewer believes that the favorable comments that this volume has received in Japan attest to its excellence. Both he and Inoue regard Watanabe’s work as important, because it systematizes the evolution of both work sheets and the trial balance. Kimizuka
and Moteki expect that Watanabe's ideas will one day be verified by analysis of actual records.


Reviewed by
Gary John Previts
Case Western Reserve University

This is really two histories—one which deals with Peat’s first 75 years—ending 1972—and the most recent decade, ending 1982. The work should have been produced perhaps for a 75th anniversary, but given the stormy events of the 1970’s, it may have been difficult for the leadership of the firm at that time to release any document which might further raise sensitive issues—as good historical research does.

The credentials of T. A. Wise, a respected business journalist, to undertake a serious investigation into one of the major accounting firms must be acknowledged. He is thorough in detail and candid in discussing the politics of the firm’s leadership selection process. There is a valuable insight provided into firm “politics” and the author seems to have had full access to the facts, and treats the issues fully; however no major practice deficiency is ever assigned to the firm. Wise does seem more an “advocate” than an objective historian.

Thus one is less convinced as to the issues relating to the firm’s experience with the SEC and governmental panels during the turbulent period between 1970 and 1980. Each episode detailed provides a balanced pro and con but there is never an overall historical judgement. Was PMM so growth oriented during this period that the quality level of work led to so many criticisms? Or were these events just a series of unfortunate “bad” judgments which could indeed happen to any major firm? The reader may get the impression that it is the latter; the reviewer must ask if the author was remiss in not evaluating the issue from the former point of view.

Little is mentioned as to the process by which the firm responded to changing social concerns for women and other minorities.

PMM’s development is treated in 12 chapters detailing the significant influence of the ups and downs of the relationship with the Peat firm in the U.K. One is drawn close to both co-founders of the U.S. firm, Marwick and Mitchell and one is also provided the
opportunity to learn about them as persons, not merely historical characters.

The treatment of contemporary practice (Chapter 11) appears to be almost an afterthought necessitated by the addressing of the current international posture of the firm. This is not a history of the international firm but a history of the U.S. firm (which has as of 1984 1,284 partners in 100 U.S. offices). Dealing with both a U.S. firm and an international firm is difficult and was not what the reader expected; thus, there is some lack of direction in the last chapters.

The bottom line of any review should weigh the pluses and minuses of the historical effort. The major deficiency of this work is that it is somewhat disjointed as between the 75th and 85th years—and that it does tend to reflect a less than critical view of the episodes of the 1970s. However, professors and historians will find this a handy guide to the firm's current leadership and organization structures. [The appendices are useful directories of key personnel and periods].

While Wise's qualifications are as a journalist, he has also proven to be an apt chronicler of events and has used his talent to bring important historical persons and events into an interpretational focus which helps the reader.

The firm is to be applauded for this valuable, thorough, if guarded, adventure into the arena of public self-review. Many firms have been unwilling to consider such an exercise—and as a result the profession's major firms continue to recede into the background—a position which they appear to welcome after the spotlight and center stage of the 1970s.
DOCTORAL RESEARCH

Maureen H. Berry, Editor
UNIVERSITY OF ILLINOIS

The process of economic development, and the multitude of problems it can provoke, provides a rich field for doctoral research in many disciplines. The current selection of dissertations, which also includes studies involving relatively recent accounting and reporting innovations, illustrates the different perspectives that can illuminate various aspects of the same object of interest.

Lister's dissertation, examining banking's role in the early development of California, gives the lead. This study, using bank balance sheets for its statistical data base, shows some of the symbiotic relationships which link accounting and economic history. A second economic historian, Ababio-Appah, looking into development issues in Ghana a century later, considers the impact of ownership concepts on economic progress. What, he asks, are the implications of attempting to move away from the basic national philosophy of collective ownership? Agbonyitor is also concerned with development problems in Ghana: but from the standpoint of public financial management. Constant difficulties over state budget deficits result from recurring expenditure allocations. Thus, the study concentrates on examining expenditure patterns in order to illuminate policy issues. Budget deficits constitute the focus of Shelley's research into the fiscal problems of American cities. Finding that fiscal stress could not be linked to financial and economic indicators, she concluded that the predominant role has to be conceded to political considerations.

Shifting from macro to micro issues of financial distress, Elkharouf tests the assumption that the international harmonization of accounting standards could improve decision making. After the extremely time-consuming exercise of restating U.S. financial statements in accordance with the French unified accounting system, he concluded finally that any resulting improvements in predictive ability were not statistically significant. A second relatively new accounting phenomenon concerns price-level changes. Fesmire's
study puts Sweeney's classic work in historical perspective, highlighting his major contributions to current practice.

Social responsibility accounting (SRA) in U.S. corporations has attracted interest among academics in Poland, where this concept is differently interpreted. Jaglinska-Bieniek, in her study of SRA in selected U.S. companies, identified certain development barriers and offered suggestions for their removal.

Bernstein's study of U.S. corporations returns to the field of economic history and moves back in time to the Great Depression. He breaks research ground by asking: "Why did the depression last so long?" rather than "why did it happen?". We conclude with Fiereder's dissertation which opens with events taking place in Europe just as the Great Depression in the U.S. was in its final phase. The public sector then began to dominate the German mining industry, and as a result, a former state enterprise formed the nucleus of a successful postwar-Austrian mining and manufacturing group.

Bank Behavior, Regulation and Economic Development: California 1860-1910 by Roger Charles Lister. University of California, Davis, 1982, 344 pp. Vol. 43/07, p. 2411-A.* Lister's research examines the role of banking in the process of economic development. California's experience during the period 1860 to 1910 was considered to be a particularly appropriate setting for this type of study because of the state's rapid economic growth at that time, accompanied by relatively few restrictions on banking operations.

The pattern of expansion by national banks in California was very similar to the process taking place in the eastern part of the country. That is, there was very slow growth before the turn of the century, due to the entrenched position of state banks and a general lack of confidence in bank notes. As the popularity of state banks declined in the early 1900s, national banks grew rapidly: aided by certain tax advantages and reduced minimum capital requirements.

Effective bank regulation depends, of course, not only on the related legislation itself but also on the extent to which it is enforced. In California, certain legal constraints, such as reserve and capital requirements, were offset by relatively flexible supervision. Turning from regulation to banking operations, banking's main contributions to economic development have come from lending activities. Lister used regression analysis in examining bank balance

*Volume and page number references to Dissertation Abstracts International.
sheet data for the thirty-year period 1878 to 1908 in order to identify important loan-related banking features. His findings suggest that, in general, less funds were made available by those banks which had the most restrictive national charters, poor capitalization, and risk averse management. Two other factors, predictable it would seem, were lack of loan demand from customers, as well as the strength of banking power over the loan market. On the other hand, banks were favorably affected by the existence of rapidly developing loan markets with a low probability of risk. Another important factor was the competitive advantage afforded by the lack of concentration, and poor performance, of existing banks in the targeted areas.

These findings are also viewed as adding to the existing research on the development of a national capital market during this same period. An interrelated issue concerns the existing differences between interest rates in various regions of the country. Other investigations have suggested that these regional interest rate variations could be attributed to a number of factors, including: risk and transaction cost levels, and alternative financial innovations. However, while agreeing that these factors affected banking behavior in California, Lister was unable to find any predominant explanation.

Land Ownership in the Economic Development of Ghana, 1945-1975 by N.W. Ababio-Appah. Lunds Universitet, Sweden, 1981, 215 pp. Vol. 43/01, pp. 20-21-C. During the past three or four decades, Ghana’s economy has, through modernization, gradually shifted away from complete dependence on an unskilled, traditional labor sector. As a part of this process, changes occurred in the system of land ownership. The primary purpose of this study was to investigate the relationship between these changes and the new direction of the economy. In order to identify the dynamics of the basic shift in conventional ownership claims, the dissertation examined several economic theories bearing on property rights. The implications of these theories were analyzed from the standpoint of their application to the agricultural development of land in Ghana. The author defined the term ‘land’ in a very broad sense to include all natural resources with possible social or economic value. The concept of ownership was construed, consonant with Ghanaian interpretation, as comprising absolute, collective land-owners as well as state ownership through statutory acquisition.

A secondary goal was to analyze certain problems associated with transforming the economy into a dual relationship between traditional and modern sectors. The modern sector originated, and
is still developing, with a predominantly unskilled labor base. Lack of skills has at least two automatic consequences: low output and low wages. Thus the two sectors are linked by a two-way flow of labor. Labor flows into the modern sector but a certain part of this stream has to return home periodically to work on family farms in order to make ends meet. Based on this sectoral framework, the author developed the proposition that a 'peasant cultivation family unit' acts as an equilibrium lynch-pin. As might be expected, the process of economic transformation ran into various problems. Probably the most significant challenge to a smooth transition can be attributed to the existing institutions which control the traditional systems of land tenure.

Interaction Between Central Government Recurrent Expenditures, Revenue Constraint and External Receipts in Less Developed Countries—The Case of Ghana: 1956-78 by Alberto Dogbey Kobla Agbonyitor. Boston University Graduate School, 1982, 233 pp. Vol. 43/04, p. 1238-A. This dissertation is essentially concerned with budget deficit problems in developing economies and deals with Ghana as a test case. Its basic assumption is that analysis of recurrent expenditure patterns is critical to understanding budget deficit difficulties. The research centered on two main areas of interest: interrelationships between certain selected variables, and the behavior of sectoral allocations. The selected variables were: aggregate recurrent spending, tax revenues, domestic borrowing, and external funding. As for sectoral allocations, governmental activities in Ghana comprise the following functions: general administration, defense, economic services, water, education, health, housing, and welfare.

An economic model of the governmental sector was constructed from statistical data, which included central government budget statements and development plans. Simultaneous equation estimation techniques were used to estimate equations for data analysis. The results of this analysis indicate that revenues and expenditures are jointly determined but that their marginal response is asymmetric. Both revenues and expenditures move directly with external funding. However, recurrent spending was found to be flexible upwards and rigid downwards in response to revenue changes. Because expenditure growth exceeds revenue growth, budget inflation occurs with increases in domestic borrowing because input prices rise.

The various sectors reacted differently to budget expansions
and contractions. Health, water, and housing were flexible while the other services displayed rigidity. Inelastic response with costs was found in all sectors: with the exception of general administration and economic services. Consequently, it would not seem feasible to try and reallocate sectoral spending through inflationary financing.

The results of this study could prove valuable for those decision makers actively involved in the governmental budgeting process. The findings not only direct attention to the longer run implications of current spending decisions but also suggest a model for sectoral expenditure plans.

**Fiscal Stress in American Cities** by Karen Lee Shelley. University of Massachusetts, 1982, 196 pp. Vol. 43/04, p. 1241-A. Fiscal stress, defined as an excess of expenditures over revenues, has become a widespread and characteristic phenomenon in American cities: particularly over the past decade or so. As a result, federal and state governments are seriously considering the possibility of introducing significant changes in public-finance-related policies. However, the development of effective policies to promote urban solvency first requires an understanding of underlying causes and institutional relationships. Shelley, therefore, undertook this study to identify and analyze some of the main contributing factors.

Her basic assumption was that social, economic, and demographic changes are expressed in terms of financial priorities through two sets of connections: the political and the financial systems. By concentrating on the financial linkages, Shelley formulated the null hypothesis that elasticities of revenues and expenditures with respect to city size and residents' income would not be significantly different between fiscally-stressed and non-fiscally-stressed cities. She gathered data for the seventeen-year period 1961 to 1978 on revenues, expenditures, population, and per capita income for 37 of the largest cities in the United States. The relevant elasticities were estimated through regression analysis. The null hypothesis with respect to differences between the two sets of elasticities was then subjected to the Chow test. This test did not disclose any significant differences and the hypothesis could not therefore be rejected. From her evidence, Shelley concluded that fiscal stress must be attributed primarily to political considerations rather than financial or economic conditions.
A Comparison of the Ability of Financial Ratios Based on Different Accounting Standards to Predict Bankruptcy by Farouk Wasef Elkharouf. University of Illinois at Urbana-Champaign, 1982, 179 pp. Vol. 43/03, p. 847-A. One of the main advantages of harmonizing accounting standards internationally, it has been asserted, is that decision making will be improved when separate sets of financial information, supporting alternative choices, are prepared in similar fashion. This assumption was tested in Elkharouf's study of the effects of a major change in the accounting system on the predictive ability of financial statements. The specific major change involved restating financial statements, originally prepared in accordance with accounting principles generally accepted in the United States, in accordance with the French unified accounting system. The null hypothesis was that there would be no significant difference in the predictive ability of the two sets of data, that is: the original version and the restated version.

Sixty U.S. firms were sampled, including thirty companies which declared bankruptcy during the period 1970 to 1975. Their financial statements for three consecutive years were restated on the basis of the French unified accounting system. This process resulted in considerably different monetary amounts for a number of items, in particular: depreciation expense, net income, and net worth. These differences were tested for significance, using a one-way analysis of variance. Four sets of multiple linear discriminant functions were created from thirty-one financial ratios for each of the two versions of the financial statements. Differences in the predictive ability of these two sets of data were examined by the chi-square and Wilcoxon matched-pairs signed ranks tests. Overall, the restated data performed slightly better than the original version. While there were some differences in the powers of the models, the multiple linear discriminant functions predicted bankruptcy well. However, due to the lack of statistical significance, the null hypothesis could not be rejected.

A Comparison of the Advocations of Henry Sweeney in "Stabilized Accounting" to Recent Price Level/Replacement Cost Activity by Walker Eugene Fesmire. The University of Mississippi, 1982, 296 pp. Vol. 43/03, p. 847-A. Although Stabilized Accounting is a classic in the field of accounting for price level changes, the full extent of Sweeney's contributions to current theory and practice has received inadequate understanding and recognition. Fesmire's dissertation, based on the premise that the recent professional literature leans heavily on Sweeney's concepts, attempts to fill this need.
First, Sweeney's work had to be placed in perspective. This required tracing the development of the related literature by reviewing and analyzing the history of arguments for and against recognizing changing prices in the accounts. Sweeney's views on the use of replacement cost, as well as historical cost/constant dollar, were presented, together with an illustrative example of accounting for changing prices. This analysis served to demonstrate the degree to which later writers were influenced by Sweeney's thinking. After the publication of *Stabilized Accounting*, very few major contributions to the price level accounting literature appeared until the 1970s. With the SEC's issuance of *Accounting Series 190*, the situation changed significantly as the debate over accounting and reporting theory expanded to cover problems of practical implementation.

The dissertation concludes with three recommendations for the accounting profession. First, that it should continue to assist business in its attempts to improve price level accounting. Second, that it should continue its own efforts to develop price level accounting and reporting technology. Lastly, that it should engage in widespread educational programs aimed at clarifying the objectives and limitations of accounting for changing prices.

*Corporate Social Responsibility Accounting in the U.S.A.—Development Barriers* by Zuzanna Jaglinska-Bieniek. The University of Lodz, Poland, 1983 (in Polish). This is a study of the theory and practice of social responsibility accounting by U.S. corporations and its main purpose is to identify and evaluate elements barring social accounting's development. The three main research questions were:

1. What factors underlie the development of U.S. corporate social responsibility accounting (CSRA)?
2. What are its development barriers?; and
3. How can they be overcome?

The dissertation commences with an historical review of corporate goals and approaches to social responsibility in the United States, drawn from the economics, political science, and sociology literature. Next, links were drawn between CSRA and conventional corporate accounting and three types of CSRA models identified: (1) those consistent with the classical view that CSRA should be a separate and optional supplement to conventional corporate accounting; (2) those based on the management concept that total
performance measurement requires measuring the costs and benefits of activities involving corporate social responsibility in addition to traditional methods of income measurement; and (3) those based on an activist concept that special measurements, other than market measures, are required to reflect the corporate impact on society as a whole.

In reviewing the practice of CSRA in certain selected U.S. corporations, two basic types of development barriers were identified. The first arises out of the cultural and political foundations of the American economy. This barrier could be removed, at least partially, through appropriate legislation such as took place in France with the requirement of a social balance sheet. The second barrier is directly related to accounting systems and concerns the problem of measuring social costs and benefits. This situation suggests that either new types of accounting models need to be developed or existing ones constantly improved. Such efforts should aim at identifying needs for full information, interdisciplinary measurement of all social costs and benefits, developing and applying accounting information standards, and interdisciplinary auditing of accounting statements.

*Long-Term Economic Growth and the Problem of Recovery in American Manufacturing: A Study of the Great Depression in the United States, 1929-1939* by Michael Alan Bernstein. Yale University, 1982, 525 pp. Vol. 43/04, p. 1241-A. Problems associated with the Great Depression in the United States have attracted considerable research interest in many fields over the past four decades. From the standpoint of economics, interest has generally centered on the depression's origins, with particular focus on the collapse of the security markets in 1929 and the following four years of progressively severe economic downturns. Bernstein's research moves away from this concentration in order to provide a longitudinal picture. His concern is with the length of the depression years, rather than why they came about.

The opening chapters of the dissertation, which provide the theoretical framework, offer a contrast to the traditional thesis associating the depression with general economic stagnation. Bernstein proposes an alternative view, based on data accumulated from studies of twelve major manufacturing industries. Through examination of industry growth rates during the 1930s, it was possible to determine which sectors of the economy were stagnant and which were relatively unaffected. The author was then able to
suggest that in a developed capitalist economy there exist long-term growth patterns. These patterns favor industries producing non-durable consumer goods rather than consumer durables or capital goods. This is because firms producing nondurable consumer goods have more flexibility with respect to innovation and sales promotion. However, this relatively successful sector was unable to induce a general upswing in the economy. It could not absorb the unemployed into its work-force or spark production in other industries. This lack of synergy can be associated with various technical and demographic problems as well as the fact that final consumer demand took on a completely different form.

The Reichswerke “Hermann Goering” in Austria from 1938 to 1945. On the History of the Foundation of the United Iron and Steel Company (VOEST) by H. Fiereder. Universitaet Salzburg, Austria, 1979 (in German). Vol. 43/03, pp. 451/2-C. This dissertation, whose topic is aptly described in the title, is in three parts. The initial section traces the development of heavy industry in Germany and Austria up to the year 1938. Included is a review of the relationships between the mining industries and the state and party offices of the Third Empire (Reich). The second part describes the nationalization of the Alpine-Montangesellschaft, formerly part of the Duesseldorf United Steelworks, as a state (Imperial) factory (Reichswerke) in 1938. The closing section deals with the establishment of the foundry in Linz and the modernization of the Alpine company by the Linz state factory. The creation of the Hermann Goering state factory in 1937 can be attributed to dissensions between the German mining industries and the German state bureaucracy. In accordance with Goering's plans, and in the face of stiff opposition from the private sector, this enterprise became one of the largest mining industries in the German empire. This was achieved mainly through political and economic coercion by the concern’s management. By 1942, however, a community of interests existed between all the German heavy industries, both state and private. After 1945, the United Austrian Iron and Steel Works (die Vereinigten Oesterreichischen Eisen-und Stahlwerke) was created out of the substantial investments in the Linz state factory and the former Alpine company. Although war damage was relatively slight in Linz, the break down of Europe's transportation systems caused initial start-up problems. The subsequent economic success of the mining industry in Austria, however, is mainly attributable to labor efficiency.
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