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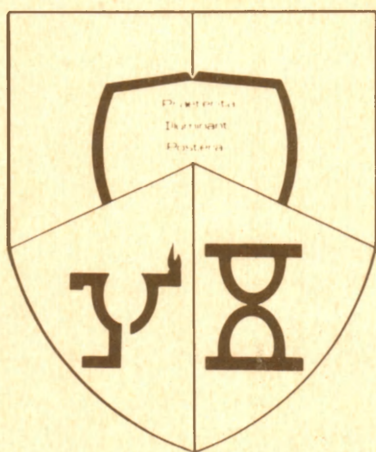

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Volume 9, Number 2

Research on the Evolution of
Accounting Thought and
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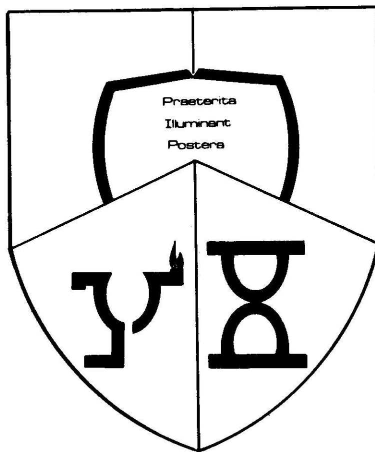

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Terry K. Sheldahl
MILLSAPS COLLEGE

REPORTING TREASURY STOCK AS AN ASSET: LAW, LOGIC, AND ECONOMIC SUBSTANCE

Abstract: This paper traces development in the accounting literature, circa 1909-1933, of dominant support for contra-equity presentation of treasury stock, and relates this overview to prominent current arguments for selective asset treatment. Classic "logical" objection to asset analysis is found to be compelling. Contemporary challenges to prevailing doctrine in terms of "economic substance," enjoying distinguished lineage from the earlier era, are recast as attractive recording and disclosure proposals. An auxiliary theme is the changing nature of relevant objection of "legalism." Sources include Hatfield, Esquerré, Montgomery, Paton, Kohler, and (of particular note) Sunley, and current analysts Allan Young and Beatrice Melcher.

The recording of treasury stock transactions is a relatively flexible area, aside from any applicable legal requirements. There are alternative basic methods, the "par value" and "cost" approaches, each permitting varied treatment of pertinent "loss," in particular. In accounting terms, however, neither gain nor loss may be recognized in reacquisition, reissuance, or retirement of stock.[1]

The corresponding reporting doctrine is that treasury stock is a negative "equity" item, not an "asset." For fully half a century this position has enjoyed overwhelming support among accounting writers; in slightly qualified form it has since 1934 had "authoritative" professional endorsement;[a] and, reinforced by SEC provisions

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Beyond the specific reference in note c, indebtedness is gratefully acknowledged to the two anonymous reviewers for their constructive comments and suggestions. An earlier version of this paper, entitled "An Historical Perspective on Asset Presentation of Treasury Stock," was presented at the 1979 Annual Meeting of the American Accounting Association—Northeast Region.

[a]The reference is to a 1934 AI(CP)A statement, still accepted as authoritative, which allows that "it is *perhaps in some circumstances permissible* to show stock of a corporation held in its own treasury as an asset, if adequately disclosed" (emphasis added). Without qualification, the Committee on Accounting Procedure in 1938 rejected both recognition of gain or loss on treasury stock transactions, and direct adjustment of retained earnings in lieu of gain recognition. Financial Accounting Standards Board, pp. 9 (citation), 10 (*Accounting Research Bulletin 43,* Chapter 1, Sections A, paragraph 4, and B).

and (since 1954) federal income tax law, it has for nearly as long prevailed decisively in practice.[2] During the years 1974-78 only 1.9% of companies surveyed by *Accounting Trends and Techniques* which held their own stock (as did 72.1% of all firms covered) carried such holdings as assets, or at least noncurrent ones.[3]

Within the past generation, however, treasury stock activity has changed markedly in nature and increased immensely in volume. In this context it has been argued that "economic substance," as opposed to "legal form," can sometimes be expressed only through asset treatment. One prominent analyst favors such presentation whenever reissuance of stock is clearly "intended" at the time of acquisition, while another one is more restrictive.

These challenges to accounting orthodoxy invite review of emergence over the first third of this century of the prevailing consensus among accounting writers. Besides development of a consensus position, two points warrant particular notice: original "legalistic" argument for uniform *asset* presentation of treasury stock; and assertion or anticipation by early authorities of a leading intermediate position taken today. Principal sources include Hatfield, Esquerré, Montgomery, Paton, and Kohler. The less celebrated author William T. Sunley, however, most incisively stated the case against asset presentation.

Confining attention to treasury "common" stock, his argument is found to express a compelling "logical" point which presupposes no distinctive economic context, beyond incorporation itself, and hence poses no obstacle to economic "realism." Even so, useful contributions are credited to current selective asset advocates Allan Young, a finance professor, and Beatrice Melcher, a research associate of the American Institute of Certified Public Accountants (AICPA), by recasting their respective positions as specific *recording* and *disclosure* proposals.

Establishment of Treasury Stock Orthodoxy, Circa 1909-1933

Early in this century treasury stock was normally carried as an asset, and as late as 1932 nearly one-half of relevant companies listed by the New York Stock Exchange followed this practice.[4] By then, there was strong consensus in the accounting literature that asset presentation is unsound *in principle*. A sophisticated minority viewpoint called for such treatment in certain instances.

Following identification of the two basic sources of reacquisition, and relevant objectives, emergence of the consensus position is documented, and argument for selective asset treatment is traced

back to 1909. Finally, a concise summation from 1933 invites clarification of the prevailing analysis relative to the "entity" theory of financial reporting.

Sources of Reacquisition, and Relevant Objectives

The basic sources of stock reacquisition, discussed in terms of pertinent *objectives* of the earlier period, are (1) *donation* by shareholders, and (2) *purchase* therefrom. *Forfeiture sale* upon subscriber default, a potential third source at the time given (contrary to present practice) prior stock certificate issuance,[5] is disregarded due to relative unimportance.

Donation

Donation, a particularly prominent source of share reacquisition in the earlier era, may serve either of two main purposes: (a) elimination of a deficit, or (b) generation of working capital.

Elimination of a Deficit

Capital stock may be donated for purposes of eliminating a deficit, as a condition of dividend payment. Such donation would today require formal retirement of the stock, as a basis for recording "additional paid-in capital" against which the deficit could be written off.[6] Early practice, however, sanctioned immediate recognition of "donated capital," at the par value of the shares.[7] The stock could then be held in the treasury for other purposes, including the raising of working capital.

Generation of Working Capital

The objective of raising working capital is uniquely significant and controversial, historically. Focus is placed upon donation subsequent to incorporation through exchange of stock wholly or principally for nonmonetary assets, such as patents, plant facilities, or mineral properties. These assets would be stated at the par value of the stock, rendering it "fully paid." Shareholders would then on a pro rata basis donate shares to the firm, possibly representing up to one-half their holdings.

The stock could then be reissued for cash at less than par, without imposing a contingent liability (to creditors) upon shareholders. A major obstacle to attraction of investment by an untested enterprise would thus be removed.

Early writers sometimes noted that inability to attract working capital at par value would not in itself imply *overvaluation* of initial assets. Original owners legitimately having strong faith in a new company might recognize need by other potential investors for special inducements.[8]

Nonetheless, the writers did not doubt prevalence of the "treasury stock subterfuge," by which the nonmonetary properties *were* clearly overvalued to avert contingent liability on sale of stock at a discount. Relevant court protection for creditors was often at best problematic.[9] Concern about this abuse may well have encouraged ready endorsement of contra-equity treatment of treasury stock, as well as advent of no-par (and low-par-value) stock.

Purchase

A prominent textbook of 1931[b] listed eight objectives of common stock "repurchase" (to use later terminology):

1. Relieving a retiring stockholder of his interest in a close corporation
2. Replacing a retiring stockholder in such a firm
3. Accommodating a stockholder
4. Eliminating a "dissident" stockholder
5. Securing shares for distribution to employees
6. Investing surplus funds
7. Taking advantage of an expected rise in market value
8. Simply reducing outstanding stock.[10]

This listing seems particularly relevant to "close" corporations. Items 1 and 2 are defined in terms of such companies, while numbers 3 and 4 are apt to be particularly asociated with them. Objectives 5 and 7 relate wholly or primarily to "public" firms.

More direct evidence that reacquisition through purchase was not prevalent among publicly held corporations in the earlier era is provided by a contemporary study identifying 1932 as a year of *unusually heavy* treasury activity. In that year twenty-six companies listed on the New York Exchange repurchased shares (aver-

[b]Through national balloting among both academic and practicing accountants, Sunley and Pinkerton's text was nominated for Beta Alpha Psi's "Most Notable Contribution to the Accounting Literature Award" for the twelve months ended May 1, 1931. Also nominated, among twenty-five books listed, were works by Roy Kester; A. H. Church, a noted cost accounting writer; historian Wilmer Green; and W. B. Castenholz, like Sunley a prominent accounting author, practitioner, and correspondence educator. The award ultimately went to Castenholz's book. Sheldahl, pp. 480-495.

aging approximately five percent of total stock outstanding), compared with eight in 1931 and six in 1933. The study concluded that "investment," in a sense embracing items 6 and 7 together, was the primary motive of such activity.[11]

These references tend to support a critic's assertion that when the orthodox reporting doctrine arose reacquisition was generally insignificant to ongoing corporate financial planning.[12] Centrality of "defensive" considerations in an era of severe *depression* must, however, be acknowledged.

"Legalistic" Arguments for Asset Treatment

Given the widespread early practice of carrying debit and credit items, as such, respectively on the asset and equity sides of the balance sheet,[13] it is not surprising that treasury stock initially was widely reported as an asset. Prominent authorities supported such practice on two narrowly "legalistic" grounds, the second of which calls to mind the virtual prohibition of treasury holdings in Great Britain.

Establishment of Monetary Value

Harry C. Bentley, in 1911, and Robert H. Montgomery, in 1912 and 1916, advocated asset presentation because stock repurchase, like purchase in general, establishes a "monetary value." Consideration rendered reflects value acquired.[14] Presumably interpreting donation through analogy, these authors viewed treasury stock as a "commodity, to be held or sold according to the wishes of management."[15]

While in essence it merely notes that reacquisition is normally a market transaction involving outflow of funds, this argument is important historically as the original rationale for recording treasury stock at cost.

Maintenance of Legal Capital, and a Related Reference to British Law

Writing in 1914, Paul-Joseph Esquerré supported asset treatment because under governing laws reacquisition generally did not reduce "legal capital."[16] Basically, the par or stated value of reacquired stock was assumed to represent continuing capitalization in accounting terms. A like position perhaps lay behind the statement of a 1922 corporate law text that "with some logical correctness" reacquired "full-paid stock" would be reported as an asset.[17]

This legalistic argument conflicts with the first one, by implying that treasury stock should be recorded at par or stated value (as holdings thereafter reported as assets often were at the time[18]). It is no more persuasive logically, in its invitation to extreme relativism through statutory variation. However, Esquerré's position draws attention to a most basic objective of legal regulation in the area, and, in turn, traditional prohibition of treasury stock in Britain.[c]

State laws by which reacquisition without retirement leaves legal capital intact serve to protect creditors, and shareholders themselves, from excessive distribution of funds. Confining repurchase to the amount of retained earnings, or retained earnings and "additional paid-in capital," they effect a trade-off between such action and dividend payout. Related protection is provided by statutory regulation of legitimate reacquisition purposes and, in individual cases, bond covenant restrictions in the area.[19]

In British law concern for possible (1) harm to creditors, (2) manipulation of stock prices by companies "trafficking" in their own shares, and (3) abuse of any formal voting rights which might be recognized led very early to outright prohibition of treasury stock.[20] The principle that a company cannot be its own shareholder was established in 1887, in the case *Trevor v. Whitworth,* and later made statutory. It was relaxed negligibly by the Companies Act of 1948, providing in specified cases for *court-ordered* share reacquisition from "oppressed" stockholders (in a clause repealed in 1980), and also forfeiture by defaulting subscribers without court involvement; and otherwise stipulating strict conditions for reduction in capital under court supervision.[21]

British corporate law also forbids a company to finance acquisition of its shares by another party, in any measure, or, if controlled by another company, to acquire an interest in that firm. The very restrictive overall policy is compromised somewhat, however, by provision for acquisition of a company's stock, or that of its parent, by *trustees* or other "nominees."[22] Also, a subsidiary having obtained an interest in another corporation *before* takeover by that firm may apparently retain it, although one authoritative source recommends divestiture or arrangement for stock cancellation.[23]

British accounting treatments have not been investigated in the present research. However, a subsidiary holding shares in its

[c]Gratitude is expressed to the anonymous reviewer who suggested making reference at this point to British law. It may be noted further that the European Economic Community has adopted stringent regulations concerning share reacquisition within member countries. Schmitthoff, vol. 3, secs. L-633—L-639.

parent company would presumably report them as an asset, although voting rights might be highly problematic. More pertinently, within the (hostile) British legal environment it would be particularly meaningful in *consolidated* statements to report such holdings as treasury stock, analyzed as an equity deduction item. This "treasury stock method" enjoys considerable support in the United States.[24]

Fleeting Influence of Legalism

The influence of early legalistic cases for asset presentation was short-lived. Montgomery himself would soon advocate *selective* asset presentation, while more generally support for uniform contra-equity treatment was becoming well entrenched.

In part such developments simply reflected an expanding sophistication in accounting thought, including assertion for accounting of greater autonomy from the legal realm. Additionally, legalistic arguments could only seem particularly unpersuasive in the light of the troublesome area of donation. While one writer suggested that donated stock might be listed at zero valuation, at the foot of the asset section,[25] it was commonly assumed that donation had immediate accounting effect. Under asset treatment, the result could only be to *increase* total asset valuation over a level perhaps already highly inflated. Reissuance at a discount would then paradoxically *decrease* total valuation.

Legalistic advocacy of asset treatment for treasury stock was promptly eclipsed by the basic argument for contra-equity presentation, ironically itself considered legalistic by present critics of conventional analysis.

The Classic Logical Case Against Asset Presentation, and Supporting Arguments

The classic logical case against asset presentation, that the idea of "self-ownership" by a corporation has no content, was advanced by William T. Sunley in 1915. Several of his contemporaries added useful supporting points.

Sunley's Classic Statement

Sunley asserted simply that the "corporate" shareholder *could* in no meaningful sense possess three capacities or rights fundamental to corporate ownership. They are participation in (a) election of the board of directors, (b) distribution of periodic dividends, and (c) distribution of assets in liquidation. Formal participation in these

areas by the company itself would in substance be proportionate assignment to holders of outstanding stock of additional votes, dividends, or assets.[26]

This point is self-evident relative to liquidating distribution. Further, while sometimes legally permitted in the earlier era, through transfer from retained earnings to dividend income,[27] formal participation in dividends clearly would have no content. Moreover, the argument is equally strong as to voting rights. Proportionate representation of either operating management or the sitting corporate directorate would contradict their basic rationale, while any other approach would be fully as arbitrary as designation of recipients of the "corporate".share upon liquidation.

Sunley could easily have extended his argument to the "preemptive right," a characteristic feature of ownership in his time. A corporation could not meaningfully *exercise* "rights" relative to itself. Any pretense in that regard could only imply their proportional increase for holders of stock still outstanding, or exclusion from issuance of the relevant percentage of shares.

Almost the only ownership entitlement available to the "corporate" shareholders is transfer of reacquired shares to other parties for value, and even it involves special legal restriction.[28]

Supporting References

It is useful to note selected supporting points, or statements, made in the earlier period for contra-equity analysis of treasury stock. In 1909 Henry Rand Hatfield stated that "In a certain sense any return of capital stock to the issuing company may be considered as a virtual cancellation of that amount of the previously issued stock,"[29] without yet (as noted below) accepting the apparent reporting implications of this interpretation. Some years later, however, in essentially a revised edition of the 1909 text, Hatfield would endorse uniform contra-equity treatment.[30]

Also writing before Sunley, Arthur Lowes Dickinson stated that capital stock "represents the manner in which its property and assets are distributed among those who constitute the corporation," and continued as follows:

> If one of those owners disposes of his shares to the corporation, he withdraws therefrom, taking with him what he considers his fair proportion of the asset value, and leaving the rest to be divided among the remaining owners.[31]

William A. Paton, just beginning his career, likewise insisted upon contra-equity treatment. Responding to the objection that "fully

paid" treasury stock would tend to be *more marketable* than unissued shares, he remarked that this difference no more warranted asset presentation than would the value to a bank of its right to issue currency justify recognition of a pertinent asset. He further advanced two *"reductio ad absurdum"* arguments effective against undiscriminating recognition of treasury stock as an asset: first, that formal retirement of shares could not intelligibly be interpreted as asset destruction; and second, that asset treatment implies that a firm could reacquire virtually all its stock outstanding without contracting its capital base.[32]

Other prominent proponents of contra-equity analysis included Hastings Lyon, Roy Kester, and R. J. Bennett and Paul Pinkerton (although, as noted presently, Pinkerton took another position in a subsequent collaboration).[33]

Early Argument for "Selective" Asset Presentation

In 1909 Hatfield introduced argument for "selective" asset presentation, despite the reference just made to his early thought, by suggesting that *management purposes* should govern reporting of reacquired stock:

> If it [reacquisition] is done with the intention of reducing the Capital Stock, certainly the stock . . . should be deducted from the amount of the outstanding stock . . . . But if the stock is not acquired with the intent of reducing the capitalization, and is not canceled, accounting practice in this country certainly justifies and, indeed, requires that it be shown among the assets.[34]

Only stock reacquired with retirement intent would on this approach be reported as a deduction item. Like his early successors in the tradition he initiated, Hatfield expressed only implicitly the basic premise of his position: that in certain cases reacquisition can reduce capital only in *form,* not *substance.*

Montgomery refined the analysis in the 1920s, in the third (1921) and fourth (1927) editions of the auditing text in which he had earlier advanced his form of legalism.[35] His new position was stated most clearly, however, in a 1923 abridgement prepared with the aid of one of his partners.

Montgomery asserted that stock "purchased for resale" (or, clearly other reissuance) should be reported as an asset at cost,[d]

[d]In his fourth edition Montgomery expressly favored reduction to "market" given a price decline regarded as permanent. Montgomery, 1927, p. 245.

while shares reacquired "without specific intention to resell" should be presented "as a deduction from the capital stock issued," at par.[36] Due to pertinent abuse, however, he called for presentation of *donated* shares as equity deduction items, at par, balanced by reduction of relevant nonmonetary asset items.[37]

Montgomery's approach differs from Hatfield's 1909 position primarily in analyzing reacquisition without clear intention in either direction, retirement or reissuance, as a decrease in capital. A secondary difference is that Hatfield had made no special provision for donation, perhaps because conspicuous abuse in the area did not yet exist.

Montgomery's position on repurchase (at least) drew support in 1931 from a most unlikely source: Sunley himself, in collaboration with Pinkerton, another early advocate of contra-equity analysis.[e] Referring to their listing of basic reacquisition objectives, Sunley and Pinkerton observed that, while only speculation and employee distribution entail reissuance intent, only reduction in capital excludes it. Varied *contextual* features, including evidence of established company policy, might indicate such intent. Even reacquisition to accommodate a stockholder or eliminate a dissident would warrant asset treatment if a buyer were secured in advance.[38]

While Hatfield wrote in 1927 that "accounting practice occasionally" followed Montgomery's approach to selective asset treatment,[39] no explicit commentary on it has been found. The closest implicit reply was Paton's negative reference to "marketability" of treasury shares as a basis for asset analysis.

The most direct rebuttal, however, is that a purpose requiring ultimate maintenance of capital might be sought through a strategy involving *temporary* contraction. Another potentially telling objection is that the position is *unworkable,* because "intention" may manipulatively be disguised. These points are of particular interest in that Montgomery's position has of late been revived, as discussed below.

Kohler's Summation: Treasury Stock Orthodoxy and the Entity Theory

With no more than minor overstatement, Eric Kohler in 1933 characterized accounting texts of the time as "well-nigh unanimous"

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[e]Sunley reverted to his original position in the revised edition of his text, involving a different coauthor. Sunley and Carter, pp. 90-91.

in supporting contra-equity analysis of treasury stock. He regarded this position as "unassailable," *if* the corporation were genuinely a "separate organism."[40]

This reference relates the consensus viewpoint to the "entity" theory of the corporation. Its essence is simply that a corporation cannot intelligibly be regarded as a partial owner *of itself.* On a "proprietorship" outlook, by comparison, the full shareholder group might be viewed as collective owner of treasury holdings, hardly a clearer interpretation.

Kohler's interpretation may prompt a contemporary objection of "legalism" against treasury stock orthodoxy, but only misguidedly. First, any meaningful analysis must presuppose the basic *concepts* of property ownership and corporate structure.

Second, it is not assumed that corporations are "real" entities, on the order of observable physical objects. Effort is invited to "pierce the corporate veil," by way of reconstructing Sunley's 1915 argument in terms of one or more standard logical fallacies, such as circularity or infinite regression. The following argument, formulated as if treasury stock *were* an asset, might serve as a first approximation:

1. Ownership of common stock constitutes "indirect" partial ownership of an evolving body of financial resources, constrained in their management by an evolving body of financial obligations
2. Ownership of common stock in a company whose resources include treasury common stock constitutes "indirect" partial ownership of that item itself, among the other resources
3. The treasury stock itself represents "indirect" partial ownership of the body of resources within which it is included
4. Hence, ownership of common stock in a company whose resources include treasury common stock constitutes "indirect" partial ownership of that item (among the other holdings), which in turn constitutes "indirect" partial ownership of that item (among other holdings), . . . , and so on, *ad infinitum.*

While adequate clarification of "indirect" ownership would be a challenging task, it should be possible to restate the case against asset presentation in line with analysis of the corporation as a "legal fiction." Before submitting final judgment, however, current argument for selective asset treatment must be considered.

Contemporary Heterodoxy, in Two Formulations

While it has prevailed decisively at the levels of both theory and practice, uniform contra-equity analysis has recently been challenged by Allan Young and Beatrice Melcher. They have in turn revived Montgomery's position, and taken a less subjective approach to selective asset treatment, representing only modest advance in sophistication.

The new "heterodoxy" is very noteworthy, however, in view of qualitative and quantitative changes having greatly enhanced significance of treasury stock activity. In the early era stock repurchase was relatively rare, and usually required contra-equity presentation in any case. Today, in significant quantities, it is commonplace, and purposes viewed by current critics as requiring asset treatment have gained prominence.

Changes in Scope and Objectives of Treasury Stock Activity

Share reacquisition, by purchase, has expanded remarkably during the past generation. From 1954 to 1969 annual repurchase by companies listed on the New York Exchange increased from 5.8 million to 64.0 million shares, representing respectively 1.02%[f] and 2.02% of total shares traded. After a brief period of decline it rose abruptly to 143.8 million shares, or 3.32% of overall trading, in 1973. In that "bear-market" year 219 companies, approximately one-seventh of the listed corporations, reacquired at least one hundred thousand common shares.[41]

A survey conducted among the chief financial executives of those companies identified the following objectives, in the order listed, as having been the most prevalent bases for reacquisition:

1. Obtaining shares for executive stock options, other incentive compensation programs, and employee stock purchase plans
2. Obtaining shares for corporate acquisition (business combination) programs
3. Improving earnings per share[g]
4. Obtaining shares for conversions of bonds or preferred stock
5. Temporarily investing surplus cash

[f]This first figure (only) is biased upward, by exclusion from the base of shares traded prior to stock dividends or stock splits, although the reduction is offset in part by inclusion of preferred shares. "New York Stock Exchange Stocks," p. 28.

[g]The SEC in 1979 adopted a requirement by which registrants must disclose impact of stock repurchase upon earnings per share. Beresford and Neary, p. 6.

6. Supporting the market price of common stock
7. Increasing the debt/equity ratio.[42]

This listing is not fully comparable to the one cited for the earlier period, which was nonranked in form, basically impressionistic, and scarcely confined to public corporations. Even so, the lists imply that reacquisition was generally much less significant to overall *financial planning* in the earlier period. Only two of the eight early objectives appear in the current list, namely, obtaining shares for distribution to employees, and investing surplus funds.[h] Further, the former one is immensely more important in the present day.

Against this background, Young and Melcher have called for re-examination of the traditional reporting doctrine.

Young's Revival of Montgomery's Analysis

Young takes the position represented by Montgomery in the 1920s, omitting, as had Sunley and Pinkerton, reference to donation. Characterizing assets as "uses of funds which still retain a service potential to the firm,"[43] he would so present all shares repurchased with clear "intention" of reissuance, for *any* recognizable management purpose.[44] Formal commitment to reissuance is considered unnecessary. Valuation would be at cost or the lower of cost or market, depending upon whether classification were "noncurrent" or (inadmissibly for Montgomery) "current."[45]

In support of this position, three contexts are cited in which management purposes are commonly accepted as central to accounting analysis: distinction between current and noncurrent assets; operating and financial leases; and stock dividends and stock splits.[46] In the latter two instances the alternative would be strict control by legal form.

Terminologically, it would be preferable to speak of "expectation" of reissuance as the condition for asset treatment, since initiative may rest with parties other than management, as in conversion of other securities to common stock. Substantively, Young's criterion invites the objection of undue subjectivity, and encouragement thereby of accounting manipulation by management.

The latter objection arises from the direct implication, largely ignored by Young, that reissuance may yield "gain" or "loss." While speculative purposes may give pause in this regard, linkage of re-

[h]Two of the other objectives cited in the prior listing, numbers 6 and 8, were cited by the contemporary financial executives surveyed, but by fewer than 10 of the 113 respondents in each case. Walsh, p. 6.

acquisition with the earnings process seems generally implausible. For example, the standard criticism of accounting for conversion of bonds at market price of either security is provision of such treatment for gain or loss.[47] Such objection can hardly be dismissed out of hand.

There is risk of severe paradox in Young's position, in any case, For example, if "economic substance" is to govern accounting treatment of reacquired stock, should not *unissued* shares be carried as an asset if they are to be placed on the market in lieu of reissuance of treasury holdings? Since "gain" on reissuance was taxable for two decades, 1934-54,[48] this case historically is realistic.

Melcher's Case for Narrower Asset Treatment

Melcher's relatively complex approach yields much narrower advocacy of asset presentation. She would require both that (1) reacquisition serve on explicit *requirement* that the company acquire its own shares, and (2) the specified purpose be of an "operating" nature rather than a "financing" one.[49] More concisely, treasury stock should be reported as an asset if it is acquired relative to an express commitment, to serve particular operating objectives. Donated stock would almost as such fail the test.

"Operating" objectives are illustrated mainly in terms of *compensation* plans, notably stock option and purchase programs, profit-sharing and bonus provisions, and deferred compensation contracts. Treasury shares may also be used for pension plan costs, sales commissions, and charitable donations.[50]

Stock reacquisition for "financing" purposes directly concerns equity interests. Objectives include (a) investment of excess funds, (b) revision in financing sources, (c) anticipation of conversions and exercise of warrants, (d) distribution of stock dividends, and (e) implementation of business combinations. Melcher disallows asset treatment in such cases on the premise that change in ownership interests alone cannot yield gain or loss.[51]

Melcher advocates asset treatment, and attendant recognition of gain or loss (as applicable), for reacquisitions "specifically *required* for a designated operating purpose,"[52] because "distributing stock to satisfy liabilities does not change the underlying nature and purpose of incurring costs."[53] Since only action by the board of directors is specifically cited, it is perhaps assumed that *contractual* commitment to stock reacquisition would ordinarily require prior board approval.

Such limitation of asset treatment is no doubt intended to forestall income manipulation through treasury stock activity. Shares acquired prior to origination of a need for treasury shares would not qualify, nor would stock acquired with the idea of discretionary reissuance in fulfillment of a given obligation, in preference either to issuance of new shares, or to distribution of cash or marketable securities.[54]

Unlike Young's, this position has some affinity with official authoritative tradition. The cryptic 1934 AI(CP)A statement on treasury stock cited in note (a) contemplated that asset analysis might on occasion be "permissible," without citing instances. The SEC, however, has approved asset reporting of shares reacquired expressly for prompt use in employee bonus or stock purchase plans, for example,[55] and otherwise orthodox analysts have tentatively accepted such treatment.[i] Melcher has gone further, endorsing *mandatory* asset presentation in these cases.

Overall, the distinction between two classes of objectives seems pertinent *if* treasury stock activity indeed relates to the earnings process. Further, the condition that reissuance be required would clearly support objectivity. At the same time, it seems a bit paradoxical to recognize gain or loss on transactions relating to compensation plans, but not ones involving reissuance of shares acquired as an "investment."

Broader appraisal of the views of Young and Melcher than has as yet been made awaits final evaluation of the basic case against asset treatment.

Reaffirmation of Orthodoxy, Accommodating Dissident Analyses

By way of conclusion, the classic argument against asset presentation of treasury stock is reaffirmed, while means are identified for deriving substantial contributions nonetheless from both Young and Melcher.

Unsuccessful Efforts to Refute Sunley's Classic Argument

Sunley's contention that a corporation cannot be an owner of itself seems generally compelling, on its own terms. Proponents of asset treatment may still submit, however, that it mainly addresses

[i]Finney and Miller, pp. 122-123. The authors cited themselves take a strictly orthodox reporting position, however.

features unimportant to modern share ownership, or that it subordinates basic objectives of financial reporting to empty logical abstractions. Failure of each rebuttal effort leaves such analysts only the bleak option of "heroic denial" that their positions *do* imply self-ownership.

Analytical Approach: Alleged Conceptual Distortion

The basic "analytical" response to Sunley's argument would be that the primary features of modern stock ownership are storage of value and eligibility for periodic dividends, and that they are respectively ignored and approached misleadingly by the argument. Treasury stock could be viewed as conferring a counterpart to participation in cash or property dividends, through "saving" dividend payout. The other features considered by the classic argument, as discussed above, might be dismissed as follows:

1. Voting privileges are generally a mere formality
2. Emphasis upon participation in liquidating dividends conflicts with the "going concern" premise of accounting
3. As indicated by declining incidence,[56] preemptive rights are relatively insignificant in the present day.

Allusion to storage of value recalls Paton's response to assertion of asset status based on "marketability" of treasury shares, at a time in which they often were more attractive to investors than newly authorized stock. The references made to other features are equally misleading. Delay in issuance of new shares likewise "saves" dividend distributions. Further, voting is *not* a formality within close corporations, although they may for example reacquire shares with reissuance intent. Moreover, assesment of liquidation prospects may properly affect decisions on retention or acquisition of stock, and their residual equity interest is the prime concern of a company's "final" shareholders. Finally, while the preemptive right has declined in overall importance, it is hardly an irrelevant or incidental feature of common stock, where it exists.

Methodological Approach: Alleged "Formalism"

"Methodologically," a selective asset advocate may insist that a purely conceptual argument making no reference to management objectives, economic implications, or other behavioral bearings must not control accounting treatments. This objection of "formalism" is a contemporary allegation of accounting legalism.

While it is an accounting truism that ultimately substance must prevail over form, the classic argument for contra-equity analysis cannot be dismissed on this basis. Two relevant points have already been made: that substantive likenesses between treasury stock and unissued shares could in no event justify asset recognition in the latter case; and that management purposes not involving reduction in capital might be approached through temporary contraction.

The decisive rebuttal, however, is that if there *are* relevant material differences between different contexts of share reacquisition, it should be possible to represent them in accounting/reporting terms without inviting logical paradox. The remaining task is to illustrate this point relative to the positions of Young and Melcher, having concluded that the orthodox doctrine on treasury stock reporting is correct.

Accommodation of the Heterodox Positions

Three possible approaches remain for giving accounting recognition to different contexts of stock reacquisition: (1) differential *recording* of transactions; (2) supplemental *disclosure;* and (3) a combination of courses 1 and 2. In an effort to salvage significant contributions from both critics of orthodox accounting treatment, the third alternative is adopted. Young's position is recast as a "recording" doctrine, while Melcher's variation is expressed at the "disclosure" level.

Basic Treasury Stock Recording Methods: A Complementary Interpretation

Practice has followed theory relative to *presentation* of treasury stock. However, accounting writers have predominantly favored the "par value" approach to *recording* of relevant transactions, while practice has generally favored the "cost" method. The two alternatives may be reconciled by recognizing them as suited to different contexts of stock reacquisition.

Historical Divergence Between Theory and Practice

In the earlier period a strong consensus developed in favor of the "par value" recording method, by which reacquisition is recorded essentially as retirement of stock, and reissuance as an independent transaction. Representative advocates of recording treasury stock at par or stated value included Paton, Kester, Hatfield, and Harry A. Finney.[57] Apparently the "cost" method, by which treasury shares

are recorded at cost and their reissuance is accounted for as a follow-up transaction, was associated too closely with the discredited reporting doctrine of asset treatment to be attractive.

The par value approach was endorsed in 1957 by the American Accounting Association Committee on Concepts and Standards,[58] and may yet today enjoy more support than the cost method among accounting writers. It was recently commended by Melcher, for nonasset contexts, and also by two parties linking the other recording procedure to asset presentation of reacquired shares, Norlin Rueschhoff and textbook collaborators D. E. Kieso and J. J. Weygandt.[59]

Even so, the cost method has dominated practice. During the years 1974-78, 86.7% of surveyed companies which reported treasury stock in the equity section did so at cost, of which 97.1% treated it as a final deduction item.[60] Classification by reacquisition context is, however, unavailable.

Proposed Complementarity of the Methods

It is submitted that recognition of the two recording methods as mutual competitors is misguided, and only forestalls effective response to advocates of selective asset presentation. A complementary interpretation advanced by Eldon Hendriksen,[61] and in a modified form having official support as well,[j] is adopted instead. Specifically, the cost method should be used whenever reacquisition occurs with clear intention or expectation of *reissuance,* whether or not a formal requirement exists, and the par value method otherwise. In the latter case, "'constructive retirement" is assumed.

The position taken parallels Young's approach to selective asset treatment, because the distinctive features of Melcher's analysis seem rather arbitrary outside such a context. First, since gain or loss would not be recognized in any case, the rationale for differential recording of reacquisition for "operating" and "financing" objectives is removed. Second, the strictures as to "requirement" of reacquisition presuppose opportunity, otherwise, for income manipulation, whereas any subjectivity within the dualistic approach adopted would affect presentation only of the equity accounts themselves. Any incentive provided in this context to manipulate

[j]In paragraph 12b of *Opinion No. 6,* the Accounting Principles Board recommended use of a "cost" basis "When a corporation's stock is acquired for purposes other than retirement (formal or constructive), or when ultimate disposition has not yet been decided." In the latter regard it differs from Hendriksen's position, supported in this study. Financial Accounting Standards Board, p. 139.

reported *accounting numbers,* themselves, is assumed to be minimal.

To leave matters at this point, however, would invite concern as to undue subjectivity in reporting, relative to management purposes themselves. A relevant requirement of *disclosure* should thus accompany the dualistic doctrine governing recording of treasury stock activity.

A Proposal as to Supplemental Disclosure

It is suggested, then, that through supplemental disclosure distinction should be drawn between shares reacquired subject to formal "requirement" of reissuance, and other holdings recorded at cost. Inclusion of such information would not only accommodate Melcher's viewpoint, but also ease the burden upon the independent auditor in attesting to the equity section of the balance sheet.

While the appropriate level of detail is debatable, in the absence of relevant empirical study of reader needs, additional information regarding treasury stock holdings might be provided in this connection. For example, a distinction could be drawn between "current" and "noncurrent" items, based upon time frame of anticipated reissuance. Such a disclosure would capture still another dimension of *Young's* position.

In summary, the area of supplemental disclosure is likely to be highly important in developing standards for treasury stock reporting.

Concluding Comment

The historical overview developed above has both recognized an enduring contribution on the part of early work relative to treasury stock reporting, and provided an invitation to contemporary research concerning specific recording and disclosure issues arising in the area. In particular, the force of the classic logical argument against asset presentation has been reaffirmed, without general dismissal of the views of heterodox analysts, past or present.

By sorting out the principal legal, logical, and economic issues whose interplay is involved, the study has identified treasury stock accounting as an area more intriguing than the volume of scholarly attention to date directed towards it might suggest.

FOOTNOTES

[1]Hendriksen, pp. 527-530.

[2]Rosenfeld, p. 767. Rueschhoff, pp. 4-5.

[3]Dick and Rickert, p. 234. Shohet and Rikert, p. 216.
[4]Rueschhoff, p. 2.
[5]Sunley and Pinkerton, p. 99.
[6]Simon, p. 706.
[7]Sunley and Pinkerton, pp. 138-139.
[8]Cole, p. 259. Cook, p. 152.
[9]Bennett and Pinkerton, p. 1107. Cole, p. 259. Conyngton, pp. 105-107. Cook, pp. 148-152. Hatfield, 1927, pp. 217-219. Paton, 1922, pp. 387-389. Sunley and Pinkerton, p. 133.
[10]Sunley and Pinkerton, p. 96.
[11]Holt and Morris, pp. 505-507.
[12]Young, p. 220.
[13]Hatfield, 1927, p. 9.
[14]Bentley, pp. 173-174. Montgomery, 1912, p. 138. Montgomery, c1916, pp. 133-134.
[15]Bentley, p. 174.
[16]Esquerré, p. 332.
[17]Conyngton, p. 104.
[18]Paton, 1922, p. 382.
[19]Simon, pp. 698-699, 698n.
[20]Boyle, sec. 13-5; Dickinson, p. 133. Schmitthoff, vol. 1, sec. 48-09.
[21]Boyle, secs. 13-5, 15-15. Schmitthoff, vol. 2, secs. A-066, A-221, A-478.
[22]Boyle, secs. 13-7, 13-8. Schmitthoff, vol. 1, secs. 48-09, 48-10. Schmitthoff, vol. 2, secs. A-027, A-054, A-165.
[23]Boyle, sec. 13-8 (recommendation). Schmitthoff, vol. 1, sec. 48-09.
[24]Cameron, Woelfel, and Pattillo, pp. 297-301.
[25]Lyon, p. 11.
[26]Sunley, p. 426.
[27]Paton, 1919, p. 334.
[28]Rueschhoff, pp. 5-6.
[29]Hatfield, 1909, p. 151.
[30]Hatfield, 1927, p. 182.
[31]Dickinson, p. 130.
[32]Paton, 1922, pp. 383-386.
[33]Bennett and Pinkerton, p. 1101. Kester, 1918, pp. 247-248. Kester, 1925, p. 181. Lyon, pp. 11-12, 14.
[34]Hatfield, 1909, pp. 151-152.
[35]Montgomery, c1921, pp. 206-208. Montgomery, 1927, pp. 244-246.
[36]Montgomery, 1923, p. 216.
[37]Montgomery, 1923, p. 217.
[38]Sunley and Pinkerton, pp. 95-97.
[39]Hatfield, 1927, pp. 181-182.
[40]Kohler, p. 336.
[41]"New York Stock Exchange Stocks," p. 15. Walsh, p. 4.
[42]Walsh, p. 6.
[43]Young, p. 224.
[44]Young, p. 223.
[45]Montgomery, 1927, p. 245. Young, pp. 225-226.
[46]Young, pp. 222-223. Young and Horwitz, p. 31.
[47]Kieso and Weygandt, p. 716.
[48]Reuschhoff, p. 4.
[49]Melcher, p. 251.

[50]Melcher, p. 250.
[51]Melcher, p. 237.
[52]Melcher, p. 251 (emphasis added).
[53]Melcher, p. 250.
[54]Melcher, pp. 252-254.
[55]Rappaport, ch. 16, p. 19.
[56]Kieso and Weygandt, p. 646.
[57]Finney, ch. 8, pp. 16-17. Hatfield, 1927, p. 183. Kester, 1918, pp. 18-19. Paton, 1922, pp. 381-382. Paton, 1919, pp. 333-334.
[58]American Accounting Association, p. 7.
[59]Kieso and Weygandt, p. 661. Melcher, pp. 242-244. Rueschhoff, p. 6.
[60]Dick and Rickert, p. 234. Shohet and Rikert, p. 216.
[61]Hendriksen, p. 529.

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VALUE-ADDED TAXATION: THE ROOTS RUN DEEP INTO COLONIAL AND EARLY AMERICA

Abstract: This article indicates that even the most recent forms of taxation find their roots firmly planted in Colonial America. The author shows that the concepts: ad valorem, transaction basis, indirect levy, multi-step collection, and taxation of net product were present during this early period. Through the use of these concepts the historical justifications for the income and sales tax system are provided and indicate a trend toward combining these concepts into one tax. The value-added tax is such a tax. The author concludes that adoption of this tax would complete a trend in American taxation which "took root" in colonial times.

In the United States the tax structure consists of transaction, wealth, and income taxes (which are transaction based). This study will investigate transaction taxes which contain concepts underlying the value-added tax. Conceptually the value-added tax is a tax on the increase in value of a good or service resulting from production or distribution which is measured at each level of production or distribution by the difference between input and output transactions (net product). In its elementary form, it is a gross expenditure tax (measured by gross receipts of the output or selling company) allowing a credit for the taxes paid on inputs. Concepts underlying the tax are as follows: The tax is (1) value based (ad valorem), (2) transaction based, (3) an indirect tax levied upon expenditure, (4) multi-step, (5) taxation of net product (thus is non-pyramiding and noncascading; a net turnover tax). Several taxes (to be discussed in depth later), are evaluated for inclusion or exclusion of these concepts in Table 1. How each contributes to the development and integration of these concepts will be investigated from the historical approach. These developments can be classified as (1) development of graduated polls, licenses, and the property tax, (2) development of specific excises, (3) development of excises, income taxes, and licenses based on gross receipts, (4) development of general excises and sales taxes, and (5) value-added taxes. The income tax will not be investigated because it is a result of the development and integration of these concepts rather than their

Table 1

*Concepts Underlying Various Taxes**

Tax Concepts	Taxes						
	Poll Tax	Property Tax	Specific Excises	Gross Receipts Tax	Net Income Tax	Retail Sales Tax	Value Added Tax
Taxation of net product					■	■	■
Multi-step				■	■		■
Indirect tax levied on expenditure			■			■	■
Transaction based			■	■	■	■	■
Based on value		■	■	■	■	■	■

*Darkened areas indicate the presence of the concept for that tax

cause, and because little has evolved conceptually since several classics in this area have been written.[1]

Development of Graduated Polls, Licenses and Property Taxes

A tax that is based on value can either be value in stock or value in trade. The first is a wealth tax, the other a transaction tax. The development of both are important to the development of the ad valorem concept in Colonial America. The development of the second is of major importance in the development of expenditure taxes.

Both types of taxes mentioned above have been cited as taxes based on "ability to pay" since earliest colonial times. In 1656 the "Articles of Confederation betwixt . . . Massachusets, . . . Plimouth, . . . Connecticut, and . . . New Haven, . . . [*sic*] (par. IV), specifically states that:

> . . . the charge of all just Wars, whether offensive, or defensive, upon what part or Member of this Confederation soever they fall, shall both in men, provisions, and all other disbursements, be born by all the parts of this Confederation, in different proportions, according to their different abilities, . . . according to the different numbers, . . . found in each jurisdiction, . . . by the poll: [however] Each jurisdiction, . . . being left to their own just course, and custome of rating themselves, and people, according to their different estates, with due respect to their qualities and exemptions among themselves, ...[2]

This provision basically allocated the cost of war proportional to males over sixteen years of age, but allowed each jurisdiction to raise the revenue however they saw fit, taking into consideration individual abilities. This concept of ability to pay endured for direct taxes until the sixteenth amendment. Ability to pay became an underlying theme of tax development; however, what constituted "ability" resulted in debate among those using the poll, property and transaction as the measure. These concepts of ability were not new to the American Colonies. Because of their ancestral and subsidiary link to the mother country, the colonies formed their taxation along British lines. In fact many colonial taxes were direct results of acts of the British Parliament. In order to put colonial laws into perspective, a quick review of British colonial laws follows.

There was constant friction between the landed and mercantile classes in England during the sixteenth and seventeenth centuries.

The friction was manifest through debate over whether customs duties, or land taxes should be levied to finance government. Since Parliament was controlled by landowners, it is not surprising that trade bore the cost of government. England's reason for planting the colonies was to promote trade with herself. Accordingly, her reason (initially) for taxation in the colonies was control of trade, not revenue generation.[3] Since Parliament was predisposed toward mercantile taxation and such taxation facilitated regulation of trade, it is not surprising that England's colonial tax policy was primarily composed of excise taxation in the form of import and export duties. The first regulation acts, The Navigation Acts of 1651 and 1660, established English ships as the only ones allowed to trade in the English colonial system.[4] In 1663 the "Staple Act" required most importation and exportation to the colonies from a foreign country to pass through England where a duty was levied.[5] The "Old Subsidy" Act of 1660 attempted to impose an ad valorem duty, through specific import duties, to protect English producers of those goods.[6] (Certain products not grown in England, such as cotton, could be shipped duty free.) Following the Seven Years' War (French and Indian War in the colonies) Parliament decided to pass internal taxes in the colonies with the specific intention of raising revenue. These were the Sugar Act of 1763 and the Stamp Act of 1765, which contributed to the declaration of independence by the colonies.[7] Another tax in the colonies was the quit-rent payable to the feudal landlord (the king).

In general, the colonies became polarized between taxation of land and trade along the same lines as the mainland. In New England, which was primarily mercantile, the poll and quit-rents grew into faculty and property taxes, and later corporate taxation. In the South, which consisted primarily of aristocratic landowners, property taxes were insignificant. This region opted for indirect taxes on imports and exports and widespread licensing. The middle colonies relied mainly on excise taxes. This is not a surprising trend since the most "equitable" tax is the one someone else pays.

Quit-Rents

The quit-rent system has its roots in feudal times when each tenant was responsible for surrendering a certain proportion of the produce of the land he worked to the landlord. Conceptually, it was a rent or tax on the value of the land in use. Because of collection and storage problems, and after the introduction of standards

and medium of exchange, these obligations became commutable in currency at a set levy per acre of land.

In the colonies, quit-rents were not revenue measures; they were tribute in recognition that colonial titles to land were subordinate to the king's. The early charters did not contain quit-rent provisions, but all patents granted after 1625 provided for a uniform annual rent of one shilling per fifty acres.[8] Quit-rents are of interest in two respects: first, they are the first use value surrogates since they were levied "per acre"; and second, such a tax called for a medium of exchange. Until 1723 "country pay" was legal tender in Delaware, including Indian strings of beads called "wampum."[9] By 1631 Massachusetts had made corn legal tender and did not discontinue "country pay" until 1694.[10] Many of the colonies used tobacco as legal tender. It is especially interesting to note that during the Civil War the Confederate States levied a quit-rent type of tax requiring every farmer and planter (after an allowance for his own use) to deliver to the government one-tenth of all his crops in kind.[11]

Quit-rents were important not only as value surrogates in themselves, but also, because they were levied coincident with other (excise) value surrogates and developed into property taxes.

Tonnage Duties

As early as 1631 Virginia imposed a tax each time a ship entered her ports, whether loaded or not, based upon the weight of the vessel.[12] Rhode Island, Providence,[13] Maryland, and Delaware had similar tonnage duties (Delaware's included use of the Delaware River).[14] These taxes resulted in intercolony squabbling[15] and were prohibited in the Constitution without the consent of Congress.[16] In many cases, the tonnage duties were payable in gun powder and shot; they had little economic significance.[17] This tax was significant because tonnage was a value surrogate and also a crude surrogate for commercial transactions since it was levied on each port entry and was based on tonnage, which is a rather crude approximation of trade value.

Poll and Property Taxes

The first general tax law in the colonies was the 1619 poll tax levied in Virginia. The levy amounted to one pound of tobacco per poll[18] (generally defined as a male sixteen years or older). Other colonies developed poll taxes. Its importance is in the fact that poll taxes lead to graduation according to wealth. As an example,

Virginia's tax was converted into a combined poll/quit-rent type property tax in 1645 by statutory levies:

One hundred acres of land at	04 lbs. tobacco
One cow 3 years old at	04
Horses, mares, geldings at	32 a peece
A breeding sheep at	04
A breeding goate at	02
A tithable person at	20[19]

Another tax based upon the poll was the faculty tax of 1634 in Massachusetts Bay. It provided for the assessment of each man "according to his estate and with consideration of all other his abilityes whatsoever," and in 1635 was changed to "all men shall be rated for their whole abilities, wheresoever it lies." By 1643 the law read that the assessment was specifically, "according to their estates or faculties, that is, according to good lands improoued faculties and psonall abilities."[20] This provision not only added the concept of property to the poll tax but also different earnings potentials since "artificers and handicraftsmen . . . by advantage of their arts and trades are more enabled to help bear the public charges than the common laborers and workmen, ..."[21] The significance of faculty (earning power) on the concepts under investigation becomes apparent if one traces that concept through graduated licenses to the widespread taxation of companies, in the later 19th century, by variable license fees based upon gross receipts and later upon income.

Connecticut (which copied the Massachusetts legislation) stated in 1715 that, "all such persons who by their acts and trades are advantaged shall be rated in the list . . . proportionate to their gains and returns," and added in 1725 that "for the future every one of the allowed attorneys at law shall be set in the annual list for their faculty, i.e., those that be the least practitioners fifty pounds, and the others in proportion. . . ."[22] This provision is particularly interesting since it is based on the value of the practice; that value being measured by its transaction base and is levied upon the producer of income (the attorney), but unfortunately is levied in regards to gross product rather than net product. This tax is a direct forerunner of gross receipts license taxes discussed later.

By 1771 the faculty tax had evolved into a composite tax which stated:

> All traders or shopkeepers in this Colony shall be rated in the list after the rate of ten per cent on the prime cost of

> all goods, wares, and merchandizes which they purchase for sale by retail (except the produce and manufactures of this Colony). And all traders by wholesale, tradesmen, artificers, tavern-keepers, and others by law rateable on account of their faculty or business, shall be rated in the list to the amount of their annual gains, incomes or clear profits . . . according to the best estimate . . . by the listers, ...[23]

Did this tax share the concepts underlying the value-added tax? Roughly, but because of its disjointed nature, it taxed less than the net product and was based on estimates rather than calculations. The first of the taxes mentioned was a tax based on value as measured by cost, was transaction based, and was levied upon the merchant rather than the consumer. However, since it was a single-stage wholesale tax it failed to tax the net product from wholesale to retail. Basically, it was a wholesale sales tax (but domestic goods were excluded). Ignoring the fact that gains, incomes, or clear profits were estimated rather than calculated from revenues and expenses, the second part of the tax was value based, based on transactions, levied on the generators of income, and was a multi-step taxation of net product, except for the retail level, since each in a line of production and distributions would pay a tax on his increment of value (revenue) over cost. So the second portion came very close to the concepts underlying both value-added taxes and income taxes. However, note that when both provisions are considered jointly at the wholesale level for nondomestic goods, the same goods are taxed to the retailer and wholesaler on the wholesale price. This makes the tax a turnover tax which was a forerunner of the value-added tax introduced in Europe in the late 1960s. So the 1771 Connecticut tax was not a valued-added tax but the concepts, in a somewhat crude fashion, were present.

As can be seen from the Virginia example earlier (which was the standard rather than the exception), the poll and quit-rent type taxes quickly evolved into property taxes with statutory rates for each type of property. Along with the use of the measurement of "faculty," these rates were surrogate substitutes for actual property values. By as early as 1656 the Confederation of Massachusetts, Plymouth, Connecticut and New Haven used direct assessment of house property values in conjunction with the listing of statutory valued property:

> . . . make a full and just list . . . of all personall and reall estates, ... Which List, and particular account, of males

> and estates in reference to Rates, . . . be presented yearly. . . . All which persons and Estates, are to be assessed and rated, by such as are thereunto appointed, for one single rate as followeth, *viz.* Every male person above sixteen years of age . . . at twenty pence by the head, and all estates both reall and personall, at one penny for every twenty shillings. And that Houses (wherein there is much difference) may be more equally rated, according to their worth, it is Ordered That the Deputies from the severall Plantations within this Jurisdiction . . . rate two Houses in *New-Haven,* which shal be as patterns for the other Plantations to rate by.[24]

This law is important not only because direct valuation of property is used today, but also because this law firmly establishes that the purpose of listings was taxation on value.

Property taxes in general are taxes on value in stock, or taxes on earnings potentials. As a surrogate of value, Georgia taxed the capital stock of banks in 1805;[25] and in 1823, New York provided that "all incorporated companies receiving a regular income from the employment of their capital" should be liable for the general property tax.[26] The taxation of corporations became important as corporate taxes evolved into gross receipts licenses and net income excises.

Licenses

Licenses are important in the development of tax concepts because (1) when a graduated license is used, it becomes a surrogate of value in trade, (2) liquor licenses evolved into excises which established the transaction based tax, and (3) licenses developed into gross receipts taxes levied upon corporations. By 1647 Providence had given authority to towns to license taverns and collect fines for disturbances resulting from them.[27] By 1662 towns were given power to grant variable rate licenses:

> . . . Power of each respective Town Council, to Grant Licences in their Refpective Towns, for the keeping of Taverns, Ale-houfes, and Victualling-houfes; they Granting no Licence under *Forty Shillings,* nor none above *Ten Pounds.*[28]

By 1672 Connecticut not only licensed taverns but also required "that no Corn or Malt whatever shall be difstilled into liquors in any

Plantation or Peculiar in this Colony without a particular licenfe for the fame. . . .[29] The licensing of liquor is important because liquor has been the subject of licenses and taxes from earliest colonial times to the present and has taken several forms, as will be seen.

Besides liquor, Pennsylvania, in 1727, instituted a graduated license for regulating peddlers (explicit objective in preamble). The license was fifteen shillings for those on foot and twenty-five shillings by horse.[30] In 1819 and 1827 Maryland instituted graduated licenses on brokers, auctioneers, and traders based upon the type of ware they sold.[31] In 1715 and 1741 North Carolina licensed "ordinary keepers and Tippling houses" and "Keepers Ordinaries and Houses of Entertainment."[32] In 1743 this colony taxed attorney's fees by levying a thirty shilling fee on each suit or petition filed.[33] As indicated earlier, systems of licenses and fees were sources of considerable revenue in the southern colonies and later southern states.

Why are the developments of colonial taxes (except excises, discussed later) so important to the development of more recent types of expenditure taxes? In these earlier taxes lie the embryos of the taxation concepts of value, transaction, net product, and taxation levied upon expenditure. The major developments in the post colonial period are the development of universality in taxation policy and the shift from taxes on value in stock to value in trade.

Development of Specific Excises

For purposes of this paper an excise is any tax on either the import, export, or sale of a specific category of good. A general excise or sales tax is an excise that is widespread or universal in that it taxes types of transactions in general rather than specified categories. Two excises, tobacco and liquor, played important roles in colonial systems.

Tobacco

It is known that tobacco export taxes in Virginia extend as far back as 1639 when the king paid the governor's salary from tobacco export duties.[34] In 1654 an act granted free export of tobacco,[35] but by 1657 the Assembly levied a tax of a shilling per hogshead upon all tobacco, to be accounted for by masters of vessels, to pay the Governor's salary (now a direct responsibility of the Colony).[36] The following year a ten shilling prohibitive tax, aimed at the Dutch, was

put on tobacco not exported to England.[37] Besides payment of officers' salaries and protection of maritime interests, the tax was intended to introduce money (first tax not levied in tobacco) and promote diversification of products.[38] The tobacco tax was not only important as a value tax, but also because of its transaction base. In 1661, the Burgesses gave a clear statement of their belief in the superiority of a transaction tax over the poll tax (this direct tax had evolved into a property tax after 1645—refer to the poll tax section) by stating that "the prudence of all nations hath provided for the defraying the publique necessary charges rather by laying an imposition upon the adventures for the staple comoditie than by taxing the persons of the inhabitants."[39]

Indirect taxation is an extremely important concept in differentiating between the concepts underlying value-added and income taxes. The income tax is a value and transaction based, multi-step net product tax but it is a direct tax upon the generator of that product. The value-added tax has the same characteristics except it is an indirect tax. So, the 1661 Burgesses' statement is significant as a turning point in the development of indirect taxation for revenue purposes (as opposed to regulatory) in America. Indirect taxation was not, however, without its opponents. In 1677, Valentine Byrd, a former Collector of Customs of North Carolina, and John Culpepper of South Carolina led a rebellion in protest of a provision of the Second Navigation Act of 1673, which placed a one penny per pound duty on intercolonial shipments of tobacco.[40] After the adoption of the constitution, states were forbidden from imposing export duties, so all state imposed export taxes ceased in 1789.[41]

Liquor

Under Dutch control, a tavernkeeper's excise on liquor was levied in Delaware in 1655. The tax was levied per volume and depended on the type and grade of liquor. A matching levy was imposed on the customer if it were consumed on the premises.[42] This tax was the first customer imposed "sales" type tax in the colonies. It is also interesting that the Dutch used three surrogates (volume, type, and grade) to approximate ad valorem taxation. Underlying this tax were the concepts of value, transaction basis, and indirect taxation levied upon expenditure. In 1669, while temporarily in British control, an excise of one guilder per "can" was levied on distilleries in Delaware.[43] By 1656, the Confederation of Massachusetts, Plymouth, Connecticut and New Haven imposed a uniform import duty on all liquor and wines, (except those from England or a member of the

Confederation). This law also levied the same tax on domestic liquor. The liquor levy was eight pence to the gallon and the wine levy was graduated by volume and brand.[44]

One of the first taxes under the Constitution was the whiskey excise tax of 1791, with rates varying from 7¢ to 18¢ per gallon at the still head.[45] The levy of this tax at the still head, rather than when sold, was one of the leading factors in the "whiskey rebellion." "Old Monogahela rye" (named after the river in western Pennsylvania) had become an essential item of barter in that area. Taxing it at the still head reduced its usefulness as a medium of exchange because in a barter transaction, the tax payable in currency would become due before currency was realized by retail sale.[46] These liquor excise provisions (still followed today) differentiate this type of tax from sales and value-added taxes. These provisions, though transaction based, are not upon expenditure but rather upon production.

Others

Besides liquor and tobacco excises, colonial taxation included import taxes on newcomers by 1633[47] servants and negroes by 1699,[48] and export duties on skins[49] and hides[50] by 1682 and 1691.

Development of Excises, Income Taxes, and Licenses Based on Gross Receipts

Taxation based on gross receipts is important in the development and integration of the concepts under study. These taxes are value and transaction based, multi-step direct (or indirect) taxes on gross product (since they are not net of the tax on inputs). Their importance can better be appreciated by comparing them to sales type taxes. Retail sales type taxes are value and transaction based, single-step indirect taxes on net product, assuming no tax is paid on capital goods. The value-added taxes are a hybrid of the two.

The first of the gross receipts taxes grew out of the practice of issuing graduated licenses. A provision of the Maryland act of 1827 that granted the auctioneer's license fee also required a tax of one percent on the value of everything sold at auction in Baltimore.[51] In 1901, Pennsylvania instituted a license fee of three percent of annual receipts on auctioneers and brokers.[52]

The first corporate gross receipts tax was levied, by New York, in 1824 on foreign fire insurance companies at a rate of ten percent of all premiums on domestic property.[53] Many other states followed

suit and extended the tax to include domestic companies until all but a few Western states had such taxes.

In 1882, Vermont instituted a graduated gross receipts tax on railroads; however, it was declared to be unconstitutionally interfering with interstate commerce.[54] In 1866, Pennsylvania imposed on every railroad, canal and transportation company a tax equal to three-fourths of one percent of the gross receipts from business conducted wholly within the state.[55] In 1889, the rate was changed, and its scope was increased. All transportation and transmission companies of every description were subject to the tax on gross receipts from passenger and freight traffic wholly within that state, and from telegraph, telephone, and express business wholly within the state, and included gross receipts from business of electric utility companies.[56] This tax was declared to be a franchise tax and to be constitutional since it taxed only intrastate commerce.[57] In *Commissioner vs. U.S. Express Co.* the legality of the double taxation feature of a gross receipts tax was challenged but upheld. The court held that the tax upon the whole of the gross receipts of an express company is not illegal double taxation, although the amounts paid by the express company to railroad companies are included in the gross receipts of railroad companies and taxed as such.[58]

The ruling itself is not so important as the challenge. The gross receipts tax is a gross product tax (or turnover tax) because a tax is levied on the same good or service each time it enters a sales transaction of an included industry. So if the same good passes through two included companies' sales transactions, the good is taxed twice. The net income tax, valued-added tax, and retail sales tax (excluding capital goods) are taxes designed to correct this turnover multiple taxation. The concept of net product was important in the development of these taxes as the dominant fiscal policies since that time.

The other type of gross receipts tax is the gross income type tax. The first income tax in the states was levied, in 1777 by Maryland, at a rate of 5s. per £ 100 on all wages, salaries, annuities, and profits of trade.[59] This tax approximated a multi-step net product tax since the sum of the value added to a product from extraction to consumption is the sum of the cost of land, labor expended plus profits (materials are summations of prior labor and profit). This tax, though advanced for its day, did not gain acceptance in the other states until the consideration of Civil War taxes, by both sides.

The first national (Union) income tax was passed in 1861. The rates were graduated and levied on gross income. The reason for

taxing gross rather than net income was not that the members of Congress were unfamiliar with the concept of net product, but rather, they were afraid to say "net" income for fear that too many personal expenses would be deducted.[60] The 1864 version of the law allowed deduction of business expenses, interest, taxes, and rent (even home rent) which made it "net."[61] The Civil War income tax is generally considered to be a direct tax; certain provisions, however, made it indirect. For example, steamboats, canal companies, toll roads, ferries, and bridges were to explicitly add the tax to the price they charged, making it resemble a sales tax.[62] The income taxes of 1894 (declared unconstitutional)[63] and 1913 are not of importance here because they are results, rather than developments, of concepts established in the Civil War period.

Another tax which is commonly overlooked, but which helped spread these concepts to the other half of the United States is the Confederate income tax of 1863. It was levied in three parts: a gross salaries tax; a business net income tax allowing deduction of prime costs; and a farm tax of ten percent of production payable in kind.[64]

The corporate excise section of the Tariff Act of 1909 was measured by corporate net income, allowing the deduction of all ordinary and necessary operating expenses from gross income.[65] This tax was the result of adding the concept of net product to the licenses and excises already discussed in this section. In reviewing this section, one sees that all of the concepts have been integrated except that the taxes are basically direct taxes rather than indirect.

Development of General Excises and Sales Taxes

As mentioned earlier, general excises and sales taxes are general taxes on transactions without respect to specific categories. Though the first authorized tax of this nature was in 1606, widespread acceptance of this taxing method did not evolve until the 20th century.

The Virginia Company charter of 1606 granted the right of imposing import duties upon goods entering Virginia. Though these duties were not universal, they appear to have been widespread in application. The letters-patent conferred authority:

> . . . to take and surprise by all ways and means whatsoever all and every person or persons which shall be found trafficking into any harbour or place within the limits of the said colony until they, being of any realms under our obedience shall pay two and a half upon every hundred of anything so by them trafficked; and being strangers, until

> they pay five upon every hundred of such wares and merchandises; . . . .[66]

This tax is a transaction tax on value; though, it appears to be paid in kind (any monetary revenue resulting only upon the sale of the government's 1/40 or 1/20 share of merchandise).

The "Old Subsidy" Act of 1660 levied by Parliament had as its objective the imposition of a five percent ad valorem duty on all imports and exports. In practice, however, it became a specific excise since a "Book of Rates" was used to apply the tax to physical measures, resulting in a hit-or-miss correspondence between tax and value.[67] This tax is significant because it attempted to tax value and was intended to be a general (universal) tax.

The Assembly of Delaware, in 1683, imposed a one percent ad valorem on all imports except liquor, which had special rates.[68] The First Congress of the United States passed a similar tax package in 1789. This tax called for a basic five percent ad valorem tax on all imports with many specific, higher, duties.[69] These taxes provided almost all of the national revenue until the Civil War Period.

Various authors (see sales taxation listings in bibliography) have attributed the genus of retail sales taxation as either 1921 in West Virginia or 1932 in Mississippi. However, this author would prefer to trace retail sales taxation to the 1899 Pennsylvania mercantile license law. Though that law provided for wholesalers and other dealers, it specificaly stated that:

> Each retailer of or retail dealer in goods, wares and merchandise shall pay an annual mercantile license of two dollars, and all persons so engaged shall pay one mill additional on each dollar of the whole volume, gross, of business transacted annually.[70]

This claim can be disputed, first, because it was a gross receipts license, and second, because it was a direct levy on the dealer rather than an indirect levy on the purchaser.

The taxes of West Virginia (1921), Georgia (1929), and Mississippi (1930) can be rejected as sales taxes on the same grounds. These taxes were basically business occupation levies. They were gross receipt turnover (multi-step) taxes.[71] In 1932, Mississippi converted to a retail sales tax by eliminating the multi-step feature.[72] Within five years, 31 states adopted sales taxes.[73]

The important feature of retail sales taxation is that it taxes only consumed goods. By not taxing capital goods, the double taxa-

tion of a gross receipts tax is avoided. If one taxes the purhase of capital goods, they are taxed again when they become part of the cost of consumed goods, through the production and distribution process.

Value-added Taxes

The value-added tax was first proposed by a German industrial executive in 1918.[74] In 1940, Senator O'Mahoney proposed a United States federal value-added tax.[75] Michigan adopted a modified version of this tax in 1953, which it retained until 1967.[76] Today all Member States of the European Economic Community use a value-added tax. The question remaining is: will the United States adopt a value-added tax?

Conclusion

Whether a value-added tax is adopted is a matter for the future. However, the possibility is strengthened by past tax policy. The concepts underlying the value-added tax (value and transaction based, multi-step taxation of net product, and indirect taxation of expenditure) were developed, though sometimes in isolation, in Colonial America. The major contributions since that time have been the sophistication and integration of these concepts. Two types of tax since colonial times have had all but two of these concepts. Two types have integrated all but one of these concepts, though the excluded concept was different for each. Gross receipts taxes were value and transaction based, multi-step taxation of gross products, which were only occasionally levied as indirect expenditure taxes. The missing features of these taxes were that they included gross rather than net product as their base and usually were direct taxes on the generators of income. (Review Table 1.) Specific excise taxes were single-step and taxed gross, not net to product. The second category includes net income taxes. These were value and transaction based, multi-step net product taxes, but were direct taxes. The last type is the retail sales tax. It is a value and transaction based, net product, indirect tax on expenditure, but is a one-step rather than multi-step tax.

Several have proposed value and transaction based, multi-step, net product, indirect taxation of expenditures. Such a tax is the value-added tax.

Whether such a tax becomes a reality, on a national basis, depends on whether the federal legislature is willing to combine the

concepts which have been thoroughly tested in the American political and economic system. This writer thinks such adoption is forthcoming since each of these concepts has stood the test of time, but no present tax combines all of these historically attractive concepts. It may be time for the ultimate integration of these concepts into a value-added tax.

FOOTNOTES

[1]See Blakey and Blakey. Seligman, *Essays in Taxation*. Seligman, *The Income Tax*.
[2]Cushing, *Laws of New Haven and Connecticut,* p. 5.
[3]Forsythe, p. 10..
[4]Parker, p. 17.
[5]Parker, p. 19.
[6]Parker, p. 22.
[7]Forsythe, pp. 10-11.
[8]Ripley, pp. 46-47.
[9]Daugherty, p. 44.
[10]Daugherty, p. 46.
[11]Seligman, *The Income Tax,* p. 487.
[12]Ripley, p. 80.
[13]Cushing, *Laws of Rhode Island and Providence,* p. 187.
[14]Daugherty, pp. 42-43.
[15]Daugherty, p. 43.
[16]Anderson, p. 40.
[17]Ripley, p. 80.
[18]Ripley, p. 18.
[19]Ripley, p. 25.
[20]Seligman, *The Income Tax,* p. 368.
[21]Seligman, *The Income Tax,* p. 368.
[22]Seligman, *The Income Tax,* p. 374.
[23]Seligman, *The Income Tax,* p. 375.
[24]Cushing, *Laws of New Haven and Connecticut,* p. 23.
[25]Seligman, *Essays in Taxation,* p. 151.
[26]Seligman, *Essays in Taxation,* p. 146.
[27]Cushing, *Laws of Rhode Island and Providence,* pp. 39-40.
[28]Cushing, *Laws of Rhode Island and Providence,* p. 147.
[29]Cushing, *Laws of New Haven and Connecticut,* p. 94.
[30]Daugherty, p. 43.
[31]Maryland Tax Commission, p. ci.
[32]Parker, p. 129.
[33]Parker, p. 128.
[34]Ripley, p. 23.
[35]Ripley, p. 57.
[36]Ripley, p. 58.
[37]Ripley, p. 58.
[38]Ripley, p. 57.
[39]Ripley, p. 28.
[40]Parker, pp. 75-82.
[41]Ripley, p. 61.

[42]Daugherty, p. 10.
[43]Daugherty, p. 13.
[44]Cushing, *Laws of New Haven and Connecticut,* pp. 33-34.
[45]Forsythe, p. 41.
[46]Forsythe, p. 41.
[47]Ripley, p. 73.
[48]Ripley, p. 74.
[49]Daugherty, p. 23.
[50]Ripley, pp. 78-79.
[51]Maryland Tax Commission, p. cliii.
[52]Pennsylvania Auditor General's Office, p. 94.
[53]Seligman, *Essays in Taxation,* p. 161.
[54]Seligman, *Essays in Taxation,* p. 172.
[55]Pennsylvania Auditor General's Office, p. 77.
[56]Pennsylvania Auditor General's Office, p. 77.
[57]Pennsylvania Auditor General's Office, p. 77.
[58]Pennsylvania Auditor General's Office, p. 80.
[59]Maryland Tax Commission, p. cliii.
[60]Blakey, pp. 4-5.
[61]Blakey, p. 5.
[62]Seligman, *The Income Tax,* p. 445.
[63]Seligman, *Essays in Taxation,* p. 693.
[64]Seligman, *The Income Tax,* pp. 485-487.
[65]Blakey, pp. 52-53.
[66]Ripley, pp. 67-68.
[67]Parker, p. 21.
[68]Daugherty, p. 23.
[69]Forsythe, p. 63.
[70]Pennsylvania Auditor General's Office, p. 89.
[71]Tax Foundation, Inc., *State and Local Sales Taxes,* p. 8.
[72]Due, p. 2.
[73]Tax Foundation, Inc., *Retail Sales and Individual Income Taxes in State Tax Structure*, p. 8.
[74]Pechman, p. 193.
[75]Lindholm, p. 1178.
[76]Pechman, p. 193.

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SOME CONTRIBUTIONS OF AND SOME CONTROVERSIES SURROUNDING THOMAS JONES AND BENJAMIN FRANKLIN FOSTER

Abstract: Thomas Jones and Benjamin Franklin Foster were two early American accounting textbook authors and teachers. Their careers, spanning the middle of the nineteenth century, occurred during a time of relatively little professional activity and interchange—causing their achievements to appear even more noteworthy. While Jones did not originate the proprietary theory, he was an early advocate of financial statements and not ledger balances as the culmination of bookkeeping. While Foster appears to have made little original contribution, the wide use of his texts appears to have encouraged greater reliance on a theoretical understanding of bookkeeping.

This study describes some accounting contributions of and some controversies surrounding two early American authors and teachers—Thomas Jones (1804-1889) and Benjamin Franklin Foster (1803-1859).[1] They were contemporaries and knew each other, Foster having been a teacher in a New York commercial school for about three years of which Jones was director.[2] Even by current publication standards, they would be considered prolific authors. Jones' various accounting books bear copyright dates from 1841 to 1875, and Foster's accounting works alone (he also wrote texts on penmanship and aspects of commercial law) extend from 1836 to 1893.[3] Before analyzing their major accounting writings, the accounting and business environment in which they practiced and taught is described.

The Accounting Environment of the United States, 1830-1880

During the time encompassing the careers of Jones and Foster, little professional activity of development occurred in accounting. Movement toward the formation of an American accounting profession was just beginning, in fact, as Jones' career was ending. By way of comparison, three years before Jones died in his mid-eighties, James Anyon, then a young employee and later a partner

in the firm of Barrow, Wade, Guthrie and Company, described the state of the art at that time in the following words:

> I had left on the other side [Great Britain] a profession full of vitality. . . . These conditions existed here only to a very limited extent, . . . public accountancy was in its infancy and . . . little known or understood as a distinct profession. . . . There were very few persons engaged in the profession, no more in fact than could be counted on the fingers of one hand.[4]

Though later research indicates Anyon's estimate of the number of accountants was low, nevertheless only a few persons actually held themselves out to the public as offering accounting or bookkeeping services. These few were concentrated, as was business, in the industrial Northeast. New York City directories from 1850 to 1869 listed three to fourteen accountants. Of them, Jones was listed in the following: 1852-53, 1856-57, 1857-58, 1859-60, 1860-61, 1861-62, and 1862-63.[5] According to Littleton, Foster was listed as an instructor in 1834 and as an accountant in 1835-37 and 1858-59.[6] In the 1870s, from twelve to forty-one accountants were listed.[7]

While all accountants certainly may not have been listed in these directories, some who were combined accountancy with other occupations such as law and the teaching of bookkeeping. Only after about 1850 is mention found of accountants whose principal occupation was public practice.[8]

The careers of Jones and Foster occurred in an era of no national accounting firms and no professional accounting organizations. Barrow, Wade, Guthrie and Company (no longer in existence) was formed in 1883, but the first "Big Eight" office—that of Price Waterhouse—was not formed until 1890. The American Association of Public Accountants, predecessor organization of the American Institute of Certified Public Accountants, was not formed until 1886.[9]

At the time Jones and Foster began to write, the proprietary and partnership forms of business dominated commerce. The corporate form increased in importance throughout the following fifty years,[10] but its effects on the practice and profession of accounting were not apparent or particularly noticeable until near the end of that period.

In general, Jones and Foster commenced and followed careers of bookkeeping and accounting in an age not far removed from American Colonial times in which non-corporate businesses prevailed. The few people engaged in a semblance of public accounting work (which initially at least was part-time) did so locally and

probably in effective isolation from each other since no record exists of attempts at professional organization in the United States before the 1880s.

Jones' Bookkeeping and Accountantship, Elementary and Practical

As might be anticipated, Jones' text was directed to use in commercial academies, as a counting house reference, and even in self-instruction. While not limited exclusively to the following categories, pupils apparently were anticipated to be aspiring merchants' clerks or merchants themselves. From his twenty years' examination of a wide variety of merchants' books, Jones felt he was able to exemplify in this text a system of instruction to prevent the student encountering situations for which he was not prepared.[11]

Jones' system of instruction was based on an understanding of the proprietary theory in contrast to then prevalent teaching devices of rule-making and account personification. According to Jones,

> At the root of all the difficulty lies the fact, that bookkeeping is not esteemed an essential or necessary part of a general teacher's qualifications. Were the subject taken up seriously by the more educated portion of the profession, we should no longer find in use a class of text books, which, whenever they fall into the hands of the intelligent bookkeeper or merchant, stamp the whole process of teaching as a farce.[12]

Specifically attacking rule-making, Jones rather pointedly tells his reader

> These rules used to teach bookkeeping, and which are made to stand in the place of the whole theory or science of the subject, will soon be numbered among the last relics of a barbarous age in teaching. How any educated man could use them is a mystery, for they do not grow out of any general purpose to be accomplished, the pupil can see no more of their meaning after applying them a thousand times, than he could at the first, because they have no meaning. The teacher can indeed proceed without studying; for as the student learns nothing, the teacher is not compelled to learn anything.[13]

Having abandoned that approach, Jones starts his analysis with the culmination of the bookkeeping cycle—the balance sheet and income statement.

> Bookkeeping implies a systematic arrangement of mercantile transactions, the purpose of which is to afford at all times ready access to the Resources and Liabilities of the party whose operations are recorded. . . .
>
> . . . when accounts have been arranged by Double Entry, they enable us, by additional accounts, to draw up another statement, *viz.* of the Profit and Losses resulting from the same operations. . . . Hence Double Entry embraces particular accounts . . . developing the present worth from two sources, the one corroborating the other, and constituting the balance of the books.[14]

Jones' book is not the first in which a proprietary approach is found, but as Chatfield notes it "has been called the first modern accounting text," since Jones "saw financial statements rather than ledger balances as the final step in the bookkeeping cycle."[15]

After introducing financial statements, Jones then proceeds to the accounts represented in them, calling the balance sheet accounts "primary accounts," and the income statement accounts "secondary." "Double Entry, then, embraces these two distinct kinds of accounts, from each of which we can deduce the present worth; and when both agree the books are said to balance."[16] Jones thus reiterates from the viewpoint of the ledger the same point made in introducing and emphasizing financial statements.[17]

The analysis moves through the bookkeeping cycle in reverse order to subjects progressively more detailed; after the financial statements and accounts in general have been discussed, the author explains the individual accounts, the debits and credits composing their balances, and the journal entries from which the accounts are posted. He brings each newly introduced point into his established scheme of financial statements supported by primary and secondary accounts. For example, when Jones is about to begin his detailed analysis of the ledger and its accounts, he states:

> Journalism, then, is the art of assigning its proper place in the ledger to each item in a transaction. To know the proper place is to know the laws, principles, and objects of each account, and a false journal entry can only be proved false by showing its want of conformity to some principle of the Ledger.[18]

When he finally reaches the point of stating rules for debit and credit, he thus is able to introduce them as a convenient technical summary rather than as rules for memorization—"The student will

now comprehend and appreciate the following brief rules of debit and credit, as they merely embody in a few words what he already knows."[19] He furthermore is not encumbered with the necessity of dispelling notions about any possible intrinsic meanings of the terms debit and credit; at the beginning of his work he briefly explains and explicitly states that "the terms . . . are used . . . merely to signify the left hand or right hand side of a Ledger account."[20]

In conclusion, Jones eloquently carried forward the proprietary explanation of accounting and may have been the first to give a dominant position to financial statements in his analysis. What rules he chose to illustrate, unlike those who relied primarily upon rule-making, were logical and technical summaries of points already thoroughly and theoretically developed and were introduced merely as a culmination to his main analysis.

Comments on the Various Works of Benjamin Franklin Foster

Benjamin Franklin Foster was by far a more prolific author than Thomas Jones, publishing accounting works in Great Britain as well as the United States. Foster established his own commercial academy in New York, a prospectus of which is dated 1837. Courses in penmanship, bookkeeping, commercial calculation and letter writing were offered.[21] Foster furthermore wrote books in each of these areas, probably for use in his academy, and his *A Concise Treatise on Commercial Bookkeeping* (1837) is another clear exposition along proprietary lines. Some historians and one of his contemporaries have not commented favorably on this work, however, for he is accused of a lack of originality, to put it gently, or plagiarism, to put it precisely, and the contemporary who accused him was Thomas Jones.

Foster's *Treatise* was designed for use in schools and academies, and the author notes that the "aim has not been to promulgate new or fanciful theories; but rather to select information from the best sources, and to embody the excellencies of the most approved writers upon the subject." His detractors would obviously agree. Foster readily concedes the basis of his study is the work of Morrison, and states that "the author is indebted to the able work of Cronhelm, for many useful hints and much valuable matter."[22] Indeed he was. (Cronhelm's work dates from 1818.) Littleton, in a discussion of proprietary theories of accounting, states that he would have included references to Foster's work "had not the author so clearly copied the theory sections from Cronhelm. Chap-

ters I, II, and parts of IV, for example, are Cronhelm's chapters I, II, III, and parts of VIII."[23]

In a letter to Thomas Jones dated August 1, 1838 and printed in Jones' text, Foster acknowledged Jones' origination, incorporated in one of his own works, of such ideas as beginning the theoretical explanation with the ledger, deducing from accounts two statements of a merchant's affairs, etc.[24] Foster's list of items borrowed from Jones was a summary of virtually all of Jones' contributions. Hatfield notes that Foster gave credit to Jones for various points in works of 1840 and 1852 (Hatfield does not specify to which of Foster's works he refers). Thereafter in succeeding works and editions nothing was said of Jones, and Foster stated that "modern publications show nothing original or systematic about them."[25]

Jones apparently was quite bitter about Foster's "borrowing," and felt that "the law of copyright has become a mere relic of old fogyism."[26] Exasperated, Jones stated that "Mr. Foster, it is true, never originates, but he is seldom long in finding some one who has thought for him; and in this instance he pounces upon one of his own order."[27]

Foster, however, may have been more "original" than would be suspected, according to Jones, since Jones noted that "a book has appeared in the name of Nixon, which is neither more nor less than Mr. Foster's compilations in another shape; . . . but the parts originating in the author of this work are therein credited to Mr. Foster, and he is from time to time referred to as the greatest author living."[28]

Jones felt Foster and Nixon were really one and the same, and concluded that Foster's originality, "differently directed, might have led to an honorable fame. But he will say this is no compliment, inasmuch as the genius and originality of many a bold highwayman has elicited the same remark."[29]

Foster appears to have been undaunted by this criticism; at any rate his books appear to have sold well. The *Treatise* ran through eight editions in the United States from 1836 to 1853, and his *Double Entry Elucidated,* printed in Great Britain (with one American edition), lasted fifteen editions, the last appearing in 1893—fifty years after the book made its debut and thirty-four years after his death. In 1909, Hatfield noted that Foster "enjoyed considerable recognition in reprint editions"[30] and one of his works, *The Origin and Progress of Bookkeeping* (1852)[31] was reprinted in 1976. This is not, however, one of the works for which he stands accused of plagiarism. It is an account of all books in English he could find on

the subject of accounting from 1543 to 1852. In *The Origin and Progress of Bookkeeping,* Foster presented a list of 159 authors and dates of publication and stated that he possessed 156 of those listed.[32] Presumably this library served as the basis of his work. Incidentally, his collection apparently met an unfortunate fate. In the inscription of a copy of *Origin and Progress* given to the Boston Athenaeum, Foster wrote, "The books in this Cat. were Shipped to Boston 'pr Deucallion which Ship was lost in April last and nothing saved. Sept. 25 '52 B. F. Foster."[33]

Jones and Foster on Balance

While Jones occupies a fairly secure place in the development of accounting thought, Foster's contributions are not so clear-cut. Notwithstanding, however, Foster's "lack of originality," which apparently troubled others more than it did him, he was involved with and may even have founded the earliest commercial school in the United States. At any rate, accounting-bookkeeping was taught formally there more than 40 years before it was first introduced successfully in universities in the United States.[34] Prior to the commercial school and others like it, bookkeeping hardly could have been taught other than through apprenticeship—being handed down from one clerk to the next—or through tutoring.

The success and impact of Jones' ideas and Foster's books are apparent. In 1853, Jones lamented that the leading features of his work appeared "'in some dozen different treatises on Bookkeeping, all purporting to be original,"[35] which unfortunately indicated plagiarism but also indicated the popularity of his work and his approach. Jones furthermore must be noted for the importance he attached to financial statements in the accounting-bookkeeping cycle. While throughout the nineteenth century many texts continued to rely on personification and rule-making, Littleton notes that from the middle of the century "personification of accounts and journalization by rule steadily diminished."[36] Their contributions become particularly noteworthy when consideration is given to the times in which they wrote—times in which no university accounting instruction existed, little or no professional activity was taking place, and the changes wrought in accounting by the corporate form of business were yet to occur.

FOOTNOTES

[1]Jones and Foster should not be confused with Edward Thomas Jones, the British writer who in 1799 wrote a truly notorious accounting work, nor E. T.'s son,

Theodore, also an accounting writer (1840), nor Theodore's son Theodore Brooke Jones, who was a good friend and associate of a certain William Foster.

[2]Hatfield, "Zwei Pfadfinder," pp. 80-86. Webster, "Benjamin Franklin Foster," p. 1.

[3]*The National Union Catalog: Pre-1956 Imprints*, s. v. "Benjamin Franklin Foster" and "Thomas Jones, accountant." *Accountants' Index,* 1921, s. v. "Benjamin Franklin Foster" and "Thomas Jones." *Accountants' Index: Supplement,* 1923, s. v. "Thomas Jones." Harry C. Bentley and Ruth S. Leonard, *Bibliography of Works on Accounting by American Authors,* vol. 1: *1796-1900,* pp. 21, 24, 34, 36, 37, 40, 153. *Historical Accounting Literature,* s. v. "Benjamin Franklin Foster."

[4]Anyon, *Recollections of the Early Days of American Accountancy: 1883-1893,* pp. 16-17.

[5]Littleton, *Directory of Early American Public Accountants,* pp. 12-13, 25.

[6]Littleton, *Directory of Early American Public Accountants,* pp. 12-13, 25. Webster, "Public Accountancy in the United States," pp. 105-106.

[7]Littleton, *Directory of Early American Public Accountants,* pp. 12-13, 25. Webster, "Public Accountancy in the United States," pp. 105-106.

[8]Littleton, *Directory of Early American Public Accountants,* pp. 12-13, 25. Webster, "Public Accountancy in the United States," pp. 105-106.

[9]Edwards, *History of Public Accounting in the United States,* pp. 50-54.

[10]Berle and Means, *The Modern Corporation and Private Property,* pp. 10-17.

[11]Jones, *Bookkeeping and Accountantship, Elementary and Practical,* title page, pp. iii-iv.

[12]Jones, title page, pp. iii-iv.

[13]Jones, title page, pp. iii-iv.

[14]Jones, title page, pp. iii-iv.

[15]Chatfield, *A History of Accounting Thought,* p. 222.

[16]Jones, p. 28.

[17]Those who wish to compare the quotations and analysis with that of A. C. Littleton in his *Accounting Evolution to 1900* should note that Littleton utilized Jones' original work *The Principles and Practices of Bookkeeping* (New York: Wiley and Putnam, 1841) which precedes the work utilized herein by twelve years.

[18]Jones, p. 26.

[19]Jones, p. 39.

[20]Jones, p. viii.

[21]Foster, "Prospectus of the Commercial Academy," in *A Concise Treatise on Commercial Bookkeeping,* p. 7. The page number refers to the Prospectus which appears at the back of the book and is separately paginated.

[22]Foster, *A Concise Treatise,* p. 5.

[23]Littleton, *Accounting Evolution,* p. 181.

[24]Jones, p. 246.

[25]Hatfield, "Zwei Pfadfinder," Homburger translation, p. 7.

[26]Jones, p. 246.

[27]Jones, p. 246.

[28]Jones, p. 246.

[29]Jones, p. 246.

[30]Hatfield, "Zwei Pfadfinder," Homburger translation, pp. 7-8.

[31]Foster, *The Origin and Progress of Bookkeeping.*

[32]Foster, *Origin and Progress,* p. 23.

[33]Webster, "Benjamin Franklin Foster," p. 2.

[34]Webster, "Public Accountancy in the United States," p. 111.

[35]Jones, p. 246.
[36]Littleton, *Accounting Evolution to 1900,* p. 177.

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CARMAN G. BLOUGH: HIS PERSONALITY AND FORMATIVE YEARS

Abstract: The article briefly explores the personality and psychological makeup of Carman G. Blough and discusses some experiences during his formative years that made Blough the person he was.

What was Carman Blough like and what were the experiences that influenced his formative years? John L. Carey singled out these features:

> . . . he was attracted by public service. He was vigorous, industrious, and self-confident, but open-minded and judicious—not doctrinaire. When convinced he was right he stood his ground, but he could disagree without being disagreeable. His candor, complete honesty, and good nature inspired confidence. He was not without the gift of diplomacy. He got along well with people. He had a sense of humor. He could relax convivially. He had no pretentions.[1]

There was another side, one where an explosive temper lurked. Paton described an episode involving a five-star general. During a horseshow attended by Blough and his daughter, the general—a big man attired in full uniform—remained standing in front of the two, blocking their view. Blough asked him several times to sit down, without success. Finally, he

> . . . jumped up, grabbed the general's coat, yanked violently, and yelled: "Sit down, damn you, or I'll knock you down." And he cocked his fist at the ready.[2]

At times his temper could fuel a defiant attitude. In 1932 he studied for the Ph.D. degree at Harvard University. After one year

he pressured Professor Burbank, head of the Economics Department, to permit him to sit for the general examination. "He kept telling me that I wasn't prepared, that I should have another year at Harvard before I came up for thè generals."[3] Finally, Blough's examination was scheduled, and a committee formed. Blough described what happened.

> I was really boiling mad because I felt sure that Burbank had put himself on that committee in order to sink me. And I got down there and I was still fuming and I went inside and he asked me this question which I recognized as a very hard question. So I sat back and tipped my chair back against the wall, and I outlined one, two, three what these fellow's positions were.[4]

One of the committee members, later relating the story to Mrs. Blough, recalled: "You husband dropped down on his chair and said, 'Now, is there anything more on that subject that you want, Professor Burbank?' "[5] Blough remembered another of the committee members asking him a question concerning accounting theory.

> I know that Professor Cole would want me to answer the question this way. But, I do not agree with that. My theory of that is so and so. I outlined it in great detail as to what my position was and why. Well, I would never have dreamed of doing that if I hadn't been so mad. I might as well have gone in all liquored up, I was ignoring all the sensible things that I should have been doing, instead of flaunting my views and opinions.[6]

Fearlessness and resolve were apparent in the way he conducted himself. He had a strong will and an independence of mind that transcended fear of personal consequences. He resolved, as far back as 1921, when he was teaching corporation finance at Wisconsin, to champion the cause of better financial reporting. Using published financial reports in class proved frustrating because they were so sketchy.

> They started right off with gross profit on sales and from then on most of them just had general selling and administrative expenses as one item and income taxes, then net income. That was it.[7]

Attempts made by Blough to obtain additional information were largely unsuccessful. Company representatives responded that in-

formation of the type requested was confidential to management and not to be disclosed.

> I made up my mind that anything that I had to do in accounting was going to do something to improve corporate reports that went to stockholders. It was their money. It was their decision to continue the management and they ought to know more than they were being told.[8]

He also entertained feelings of inadequacy. In explaining his motive for leaving the Securities and Exchange Commission (SEC) in 1938 to go with Arthur Andersen & Co. he confessed to

> . . . a childish feeling that I was not a full-fledged CPA until I had worked with a big accounting firm on big jobs. . . . I had the feeling that I was kind of a neophyte at accounting procedure, in the accounting field, even if I was Chief Accountant of the SEC. I had the feeling that I wouldn't be a full-fledged accountant until I had been a partner of one of the big firms.[9]

These traits were mixed with a strong concern for doing what was right. When he left Arthur Andersen in 1942 he was a partner, earning over $20,000 a year. He resigned during the heat of World War II to take an $8,000 job with the War Production Board, explaining the sacrifice in this way:

> I just cannot reconcile my conscience. If I can do something like this, which I think is worthwhile to the country, why I just can't selfishly refuse to do it.[10]

By 1943, Blough had been appointed to a deputy director's position with the War Production Board. He was responsible for issuing Certificates of Necessity, which permitted rapid depreciation of certain facilities dedicated to the war effort. One incident involving a public utility company again illustrates his resolute nature and indifference to the threat of personal consequences. The utility had been urged by government officials to build a new plant which had been in planning for several years. They agreed, but then insisted on a Certificate of Necessity to depreciate the plant over five years. Blough refused to grant one.

> They went to the head of the Public Utilities Division of the War Production Board who had been putting the heat on them to build, and got him to come down and discuss the

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> situation and almost demand that I give it to them. Which I didn't. I still refused to do it.[11]

Another important side to Carman Blough was his pragmatic nature. In 1964, the Accounting Principles Board had to reverse an earlier opinion (*Opinion No. 2*) when it was literally forced to issue *Opinion No. 4.* Blough, a member of that board, explained,

> I think that from a practical standpoint it was better to change. But from an accounting principles standpoint I still think the first one was right. . . . From a practical standpoint, to maintain [acceptance of] the bulletins having some authority it's better to retreat from a position that is not going to be accepted than to insist that that's the best theory and you'd better stick to it. Because . . . the more violations you have, the more people get the idea that it isn't worth it. It's a bit like prohibition.[12]

Having briefly explored the personality and psychological makeup of Carman Blough, it is time to turn back to his formative years in search of the experiences that made him what he was.

The Formative Years

Carman Blough was born in Johnstown, Pennsylvania on November 11, 1895, the son of Silas S. and Mary Wertz Blough. Silas Blough was a minister in the Church of the Brethren. Carman's church-oriented childhood and adolescence were very influential in formulating his later views and philosophies. When Carman was five years old his father was sent to open a mission in Pittsburgh. Following that assignment, Silas Blough went to the church seminary in Chicago, Illinois. Carman had finished one year of high school in Batavia, Illinois, when, in 1911, the family moved to North Manchester, Indiana where Silas became the head of the Bible Department at Manchester College. These many moves were to set a pattern for Carman Blough's own life once he moved away from his parents. His family's religious orientation also influenced his values to a very significant degree. As Blough himself pointed out, ". . . I was a minister's son and I went to church school and emphasis was placed on right and wrong and morals and honesty and so forth."[13]

Upon moving to North Manchester, Blough enrolled as a sophomore in Manchester Academy. His course work included a course in bookkeeping which he later taught while in college. After gradu-

ating in 1914 he was admitted to Manchester College. There he took other bookkeeping courses and in 1915, using the accounting skills he was developing, was engaged to set up a bookkeeping system and train the bookkeeper for a department store in North Manchester. He also closed the books at year-end, prepared financial statements, and prepared a federal income tax return—the first ever required under the 1913 law. Enthralled and challenged by this experience, he decided that he was going to be a CPA.

On a very cold night during his freshman year at college, Blough and fifteen other students set out to journey to another school where a basketball game was scheduled. They took a horse-drawn hack to the railroad station six miles away. On route, the driver drove in front of an oncoming railroad train. The train smashed the hack to pieces, causing Carman to lose his right arm. Determining that the loss was not going to handicap him, he took up tennis, eventually playing on the Manchester College team before graduation. Throughout his life he was to be intolerant of anyone who displayed a hint of condescension because of his impediment.

Career Beginnings

Following graduation from Manchester in 1917 with a bachelor degree, he accepted a teaching position at Bridgewater Academy in Virginia. There he taught advanced bookkeeping, commercial law, shorthand, and typewriting. He was placed in charge of the men's dormitory and also required to coach the basketball and baseball teams. All of this, as well as his teaching duties, earned "the munificent sum of $60 a month, plus board and room. So I decided I wasn't going to remain and I joined a teachers agency. That was the first job I ever went after myself; the only job I ever went after."[14] The teachers agency found him a position starting in the fall of 1918 as head of the business department at Fond du Lac High School in Wisconsin. First, however, he spent the summer of 1918 at Columbia University where he took public school administration, methods of teaching bookkeeping, and advanced accounting with Roy Kester.

During his tenure as department head, the University of Wisconsin sent an extension teacher to Fond du Lac to start a class in accounting for local businessmen. Blough signed up for the course because, "I wanted to get all that I could."[15] Towards the end of the course, the teacher talked to Carman about going to the University of Wisconsin for advanced work, something Carman had wanted to do but could not afford. With the assistance of this teacher, and

Fay Elwell, the head of the accounting department at Wisconsin, Blough was able to get an assistantship in the accounting department at the university. His move to Wisconsin ended a two year stay at Fond du Lac. Because he was interested in having a better background before teaching at Wisconsin, Blough attended summer school in 1920 at the University of Chicago. Blough spent two years at the University of Wisconsin, graduating in 1922 with a Master of Arts degree. In the fall of 1921, Blough sat for the CPA exam in Wisconsin. He passed all but the auditing section and, due to other circumstances was forced to take the entire exam again in 1922, which he passed.

Shortly after beginning work with the Wisconsin Tax Commission, Carman met and married Katherine Flory, a native of Bridgewater, Virginia, who was at that time teaching at a college in Ohio. They were wed on August 17, 1922 and later had a daughter, Betty. Katherine was to be a great influence on his life. She and her daughter, who was to later marry, both live in Bridgewater today.

In his new job he was a corporation income tax field auditor. He held this position for the better part of a year, became assistant to the division head and, in 1924, was promoted to head of the Public Utilities Taxation Division—also a part of the Wisconsin Tax Commission. This job was akin to being a securities analyst and established contacts for Blough that led to his first position with the SEC. His next move, in 1927, was promotion to Secretary to the Wisconsin State Board of Public Affairs. He was responsible for the audit of various state units and for preparing the state budget. When Blough was appointed to this post he was thirty-one years old, the youngest man ever to hold the job.

Blough held the position until 1929 when he resigned with the election of a new governor. In his last year in Wisconsin, he served on the State Board of Accountancy.

Back To Academe

In the fall of 1929, Blough returned to academe by accepting the University of North Dakota's offer to become the head of their accounting department. In the fall of 1932, he took a leave of absence to pursue a doctorate degree at Harvard. After completing one year of course work Blough requested permission to sit for the general examination and, despite the faculty's reluctance, passed with distinction. He had also virtually completed his dissertation on the topic "The Intercorporate Relations of Public Utilities with Reference to Regulation and Management." This research was later to

prove very useful to the SEC in helping to set up a uniform classification of accounts for holding companies. Unable to successfully complete the foreign language requirement, Blough never did receive the doctoral degree.

In the spring of 1933, during the depth of the depression, Blough received a letter from the Dean at North Dakota telling him that the state legislature had cut all faculty salaries. Blough's salary had been cut from $4,000 to $1,800 annually so "I started looking around for something else to do."[16] A new opportunity quickly arose. In 1933, the Bloughs moved to Chicago where Carman became a professor and head of the commercial department of Armour Institute of Technology. Blough was there for only a semester when Armour Institute found itself in financial trouble. In the spring of 1934 the faculty was told that they could not be paid prior to the following fall, after the students had registered and paid their fees. Carman found himself looking for something that would carry him through the summer of 1934, with the intention of remaining at Armour Institute. His search led to a job with the Illinois Commerce Commission redesigning their uniform system of accounts for electric utilities. Blough's work would later be used by the National Association of Railway and Utility Commissioners in rewriting the regulations for public utilities.

In 1934, the Securities and Exchange Commission was created and one of the appointed commissioners was George Matthews with whom Blough had had contact in Wisconsin. The Commission was looking for someone with accounting knowledge to join their staff of financial analysts and they approached Blough to see if he would be interested. He was. In November of 1934, after Carman had found a suitable candidate to replace him in his job with Armour Institute, the Bloughs moved to Washington where Carman was to assume a new position with the SEC.

FOOTNOTES

[1]Carey, p. 227.
[2]Paton, p. 3.
[3]Ward.
[4]Ward.
[5]Ward.
[6]Ward.
[7]Ward.
[8]Ward.
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CARMAN G. BLOUGH'S CONTRIBUTIONS TO ACCOUNTING: AN OVERVIEW

Abstract: A focus on the years of Carman G. Blough's life in which he made significant contributions to the accounting profession.

Carman G. Blough came on the national scene (1935) at a point in time when accountants were held in low regard by the public. Accountants were forced by environmental factors to accept a greater responsibility for the financial statements and to clarify accounting and auditing practices and procedures. As Chief Accountant for the Securities and Exchange Commission (SEC) and later as Director of Research for the American Institute of Certified Public Accountants (AICPA), Blough became a stabilizing influence that helped the profession develop greater consistency and uniformity.

The Years with the SEC

Blough joined the staff of the SEC in 1934 as a financial analyst and was appointed the Chief Accountant of the Commission one year later.[1] As the first Chief Accountant of the Commission, Blough had the task of establishing the duties and responsibilities of that position. Blough felt that the office of Chief Accountant should not have administrative responsibility over public accountants but the profession might look to the Chief Accountant for assistance in policy and principle decisions. Moreover, questions concerning accounting methods followed by registrants should be forwarded to the Chief Accountant for final decision.[2] The Commission agreed with Blough's concepts and took steps to clarify the duties and functions of the new position. Under the direction of SEC Commissioners, Blough was able to gain control over accounting problems facing the Commission.[3] A measure of the soundness of Blough's organizational concept is to note that the office of Chief Accountant is today still organized along the functional system advanced by him.

Blough also had a responsibility to effectively administer the accounting policies of the Commission, especially in the area of accounting principles. The task was particularly difficult because there was no clear interpretation of the term "accounting principles." To overcome the problem, Blough developed a series of well-conceived steps, each leading the profession toward a more uniform application of accounting principles.

Blough began by consulting noted accountants for their thoughts and ideas on accounting principles. While few, if any, immediate benefits resulted from the correspondence concerning the definition of accounting principles, there were several by-products that would later be used by Blough to influence accounting practice. For example, due to Blough's position he was able to establish a dialogue not only between government representatives and accountants but also between public accountants themselves. He recognized that accountants of that period frequently labored under mistaken concepts because the principles underlying accounting practice were rarely discussed.[4] The transmission of preferable accounting methods became an important part of Blough's life and can be traced throughout his monthly column in the *Journal of Accountancy.* Moreover, the diversity of opinions expressed in the letters he received led Blough to conclude that no government agency could develop a set of accounting principles to please everyone, and, more importantly, fulfill all the needs of financial statement users. This last concept led Blough to believe that government should not formulate accounting principles, but rather lend some form of guidance to the accountants involved in the development of uniform standards of practice, which inspired the issuance of *SEC Accounting Series Release (ASR) No. 1.*

The need for uniformity is again brought out in a speech Blough made in the fall of 1937 to the New York Society of CPAs. The final paragraph of his speech summarizes Blough's thoughts:

> This discussion has been mainly devoted to the recital of the variations in accounting practices followed by members of the profession because I saw no better way in which to bring home to you the extensiveness of the need for greater uniformity as we see it in our day-to-day work. What the future policy of the Commission will have to be I am not prepared to say but we are reluctant to undertake the prescription of principles to be followed except as a last resort. It is hoped the profession will itself develop greater consistency in the many places where uniformity

> appears essential to avoid confusion in the presentation of financial data and you may be assured the Commission stands ready, in whatever way it can, to assist the profession in accomplishing this purpose.[5]

In a forceful and direct manner, Blough made the accounting profession aware of the need to develop uniform accounting practices or face further intervention by the SEC.

The final step taken by Blough to promote development of uniform accounting practices was in *ASR No. 4.* In this Release, the SEC stated that financial statements should be based on accounting principles that have "substantial authoritative support." The term "substantial authoritative support" was not defined in the Release, which led to many problems in interpretations. William W. Werntz, who was appointed Chief Accountant after Blough left in May 1938, wrote Blough for his definition, to which Blough responded:

> In my mind it has meant authority of substantial weight rather than the predominance of authority. Thus, two contrary procedures might each have "substantial authoritative support" so that no matter which the registrant followed, adequate disclosure in footnotes, in the accountant's certificate or on the face of the statement, as appropriate, would be accepted without any change being required in the body of the statements. You will remember in this connection that we thought because two particular, well-known, national accounting firms other than the certifying firm had supported the procedure followed by a certain investment company, we could not say that it lacked "substantial authoritative support." That did not mean that those same two firms would always constitute "substantial authoritative support" when they were in agreement, although undoubtedly they would bear considerable weight. They were considered to be "substantial authoritative support" in that particular case because of the large proportion of the investment trusts audited by one or the other. It should also be assumed that appropriate disclosure would be sufficient without "substantial authoritative support" for a particular procedure if the question involved was a new and quite unsettled one.[6]

Ironically, the analogy used by Blough of the "two well-known national accounting firms" was to almost parallel the circumstances

surrounding *Accounting Principle Board (APB) Opinions No. 2* and *No. 4* on the investment tax credit. In that instance, Blough felt that opinions from the newly created APB should be considered "substantial authoritative support." The SEC, however, did not concur with Blough's belief that the APB should be the sole governing authority.

The American Institute of Accountants (now the American Institute of Certified Public Accountants), aware of the actions taken by Blough, voted in 1938 to reorganize the then existing Committee on Accounting Procedure. The result was to expand membership of the Committee, to include academicians, and to create the position of Director of Research. Thus, the challenge placed by Blough before the accounting profession in his New York speech altered the method of formulating principles and procedures. This action taken by the Institute could not have been more timely, for Blough had received a letter from the Commission authorizing him to establish accounting principles as he saw fit.[7]

The Years in Practice and Government

After issuing *ASR No. 4* and receiving positive responses from the Institute that action would be taken to establish uniform accounting practices, Blough left the office of Chief Accountant. In 1938, Blough accepted a position offered him by Arthur Andersen & Co. on the recommendation of Paul Grady.

Interestingly, not long after Blough left the SEC, the accounting profession again became the target of intense criticism that threatened further government intervention. The McKesson-Robbins Case had a profound impact on the profession by placing many accountants on the defensive. In an article written in 1940, Blough displayed not only a continuing faith in the profession but also a belief that accountants could benefit from this difficult experience. In part he stated:

> Mere repetitious mention of our limitations not only tends to destroy public confidence in us, but to weaken our confidence in ourselves. We would do much better to analyze our situation constructively, to look at the basic reasons for the importance of the position we hold in modern industrial and financial life, to stress the valuable part we can and do play, and to seek methods of increasing our usefulness.[8]

Actively pursuing this idea of positive involvement in the development of accounting principles, Blough helped establish for Arthur Andersen & Co., an internal program of accounting research, a program that still exists in the firm today. Blough was made a partner in Arthur Andersen & Co. in 1940.

With the outbreak of World War II, Blough saw a need to again offer his services to the government. Starting in 1942, Blough was either chief or director of a series of bureaus and departments in Washington, D. C. During this period, Blough was also elected president of the American Accounting Association (1944). Blough's contribution to the war effort was particularly sacrificing, for not only did he leave the financial security commensurate with a partnership in a large CPA firm, an employment contract with Arthur Andersen restricted him from accepting a position with a competing CPA firm for four years.

The Years with the AICPA

Toward the end of the war, Blough's duties with the government began to diminish, at which time he began seeking a new position. Feeling honor bound, even though not legally restricted, to uphold his contract with Arthur Andersen, Blough refused to work as a CPA but accepted the position as the first full-time Director of Research for the AICPA. With the appointment of Blough, the pace of research activity quickened. Prior to Blough's appointment, the Institute's response to accounting problems had been slow and frequently failed to answer problems in a direct and clear manner.

Blough was tireless in his efforts to improve the research area. Although forceful, he also was fair and democratic. He began to establish communications with various professional organizations through responses to inquiries. In addition to conferring with these organizations, he forwarded copies of subcommittee reports, discussion papers, and interim drafts to both state and chapter committes on accounting procedures.[9]

Moreover, in order to establish a dialogue between accountants and the Institute, Blough began in Febraury 1947, to write a column for the *Journal of Accountancy* entitled "Accounting and Auditing Problems." His monthly article ran until 1963 and not only concerned practical problems facing accountants but became an unofficial organ for the Institute to present problems that the private rule-making body believed did not require an official pronouncement but did necessitate clarification. While he wrote with meticulous care and in a manner that was understandable, he was less

concerned with appearing scholarly than he was with helping his colleagues and the accounting profession. In 1957, the Institute compiled a number of his articles into a book entitled *Practical Applications of Accounting Standards*.

Under Blough's guidance, the Research Department began in 1946 compiling an annual survey of accounting practices that were reflected in the annual reports of major American corporations. The report was published in 1948 and entitled *Accounting Survey of 525 Corporate Reports* (title later changed to *Accounting Trends and Techniques).* The objective of the survey was to present a "statistical analysis of corporate accounting as it is actually practiced."[10]

The Later Years

When Blough retired from the Institute as Director of Research in 1961, he also retired as Adjunct Professor of Accounting at Columbia University where he had taught since 1947. Blough was, however, able to continue publishing his monthly column in the *Journal of Accountancy* until 1963 while living on his farm near Bridgewater, Virginia. In addition to his monthly contribution to the *Journal,* Blough served as an active member of the Accounting Principles Board (1959-1964), was a consultant to Arthur Young & Co. (1961-1963), Educational Director of the International Accountants Society (1964-1971), a professor or Distinguished Visiting Professor at five state universities, and served as an expert witness in many court cases.

During his professional career, Blough received many awards and acclaims, including the honorary Doctor of Laws degree from Manchester College (1944), the AICPA's Gold Medal Award (1953), the Alpha Kappa Psi Foundation Accounting Award (1955), and the honorary Doctor of Business Administration degree from Bridgewater College (1972). Two professorial chairs (1969 and 1981) have been established in his name at the University of Virginia's McIntire School of Commerce.

On an individual basis, Blough probably helped more accountants than any other person in the profession. Future generations will continue to benefit from the analytical excellence that he brought to the accounting profession. In Blough's final years, he wrote few articles and rarely made speeches, but he warmly greeted visitors to his farm or apartment in Virginia until his death on March 9, 1981.

FOOTNOTES

[1]Burns and Coffman, pp. 8-9, 73.
[2]Cooper.
[3]Barr, p. 2.
[4]Cooper.
[5]Blough, "Some Problems of the SEC," p. 14.
[6]Blough, Letter to William W. Werntz.
[7]Cooper.
[8]Blough, "The Auditor's Responsibility to the Investor," p. 1.
[9]Blough, *History and Operations of Committee on Accounting Procedure,* pp. 6-7.
[10]American Institute of Accountants, p. IV.

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TAYLOR'S CONTRIBUTION TO COST ACCOUNTING: A COMMENT

Abstract: Frederick Winslow Taylor developed a system of cost accounting while at the Midvale Steel Company (1878 to 1890). In their article on his contribution to the development of cost accounting, Chen and Pan suggest that Taylor has not received the credit he deserves. They also assert a close association between cost accounting and scientific management. Finally, Chen and Pan compare Taylor's work with a book published in 1885 by Metcalfe.

In this comment, Taylor's contribution is more critically evaluated. As he did nothing to promote cost systems, it is concluded that he has received the credit due to him. Metcalfe's book is also evaluated, and placed in the perspective of other publications of the period.

Chen and Pan's article on Frederick Winslow Taylor's contributions to the development of cost accounting[1] is another in a long line of papers asserting a connection between scientific management and cost accounting. That connection is undeniable. But Chen and Pan's claims about Taylor's role is overstated. More importantly, perhaps, their claim that "an introduction to his [Taylor's] work in cost accounting . . . provides better understanding of his system of scientific management in general"[2] suggests a fundamental misunderstanding of the nature of both cost accounting and scientific management. Taylor's (and others') systems of cost accounting involved the classification and grouping of expense items so that "all such items as interest, depreciation, taxes, insurance, sales and traveling [*sic*] expenses, as well as all of the more direct expenses of the business may be charged directly and equitably onto the sources from which we derive our income."[3]

Scientific management, on the other hand, required detailed planning of the physical production, and a clear identification of the work to be undertaken by each worker. The only obvious connection between these requirements and cost accounting is that the job sheets or cards can be used for both purposes. The significance of this connection for the development of cost accounting will be explored in greater detail below.

There are two other points raised by Chen and Pan which deserve comment. They state that "accounting history has not done justice to Taylor's contributions."[4] That should not be a cause for wonder. As I pointed out in a discussion of the inter-relationship between scientific management and cost accounting, "It is curious, however, that neither Taylor nor his immediate associates H. L. Gantt and A. C. Barth wrote publicly about cost accounting prior to 1914, although they were obviously not ignorant of it."[5] As other writers, such as Metcalfe [1885], Fowler [1888], Halsey [1893], Arnold [1896], and Lane [1896, 1897] in the United States, and Garcke and Fells [1887], Norton [1889], Liversedge [1890], Mann [1891], and Lewis [1896] in the United Kingdom were doing much to promote costing, it is right that history should accord them the credit. Taylor and his colleagues were, it seems, fully occupied with questions of "gain sharing," "bonus rates" and "piece work." And it is for their contributions to that aspect of industrial management that they are best known.

Chen and Pan also suggest that it is unlikely that Taylor installed any accounting system, as such, while he was working with the Midvale Steel Company (1878 to 1890). Yet in the previous paragraph they refer to "several features of his system" derived from a "short paper found in his Midvale file."[6] Moreover, in a commentary on Metcalfe's 1886 paper, Taylor states: "I have read with very great interest Mr. Metcalfe's paper, as we at the Midvale Steel Company have had the experience, during the past ten years of organizing a system very similar to that of Mr. Metcalfe."[7] Taylor goes on to speak of his "experience," what "we have found," what modifications have been "adopted," and so on. There can be no doubt that he was speaking of a system which was in operation, and which by 1886 had been in operation for a number of years. Nor was that unusual. Metcalfe referred to the system as one he found "used in several shops,"[8] and several commentators appeared to be speaking from personal experience.

Unwarranted Association[9]

The connection between the scientific management movement and cost accounting is both interesting and contentious. One view is that scientific management was made possible by the developments in cost accounting. Chapman claimed that the popularity which Taylor enjoyed arose because

> . . . business management was getting more scientific, and because a certain development in Cost Accounting

> had rendered measurements possible which were not possible before.[10]

An alternative claim was that the collection of costs was a "by-product of the means used for increasing efficiency."[11] And this was the view shared by Taylor: "It has been truthfully stated that the Cost Department under the Taylor System of Shop Management is a By-Product of the System."[12] Other authors were less circumspect. Holden Evans was very active in the early years of this century, and in 1911 he published a book entitled *Cost Keeping and Scientific Management.* In it, he claimed

> Scientific shop management and accurate cost keeping are inseparable. Scientific management cannot exist without accurate costs.[13]

Chen and Pan are right in the emphasis which they place on cost apportionment. Taylor paid a great deal of attention to the allocation of indirect costs because he considered it necessary for the determination of "accurate costs" to be used in

> setting the selling price of an article and to determine the amount and source of profit for the different products manufactured.[14]

It is important to recognize the different functions being referred to by these authors. Scientific management was designed to increase productivity, eliminate waste, and make individuals feel responsible for their assigned tasks. Costing was needed for pricing and identifying the sources of profit. These are not incompatible aims, but neither are they the same. Taylor did not confuse them, but other advocates did. Evans described one of the purposes of cost keeping as being "for the benefit of the manager, to show him where economies may be effected."[15] He asserted the need for the allocation of overhead, but then denied its relevance:

> The overhead charges are in no sense a measure of the efficiency of a plant, the only measure of efficiency is *total* cost and I care not how high the overhead charges go as long as *total* cost is right.[16]

Similarly, and perhaps more blatantly Hamilton Church, who proselytized amongst engineers during the first two decades of this century, and was probably responsible more than anyone else for the popularisation of costing systems, confused the two aims. He claimed that

> The modern principle of predetermination of standard time-cost requires to be supplemented by similar standardization of overhead burden.[17]

What is not explained is how that standardization of overhead costs can assist with the task of identifying "available inefficiency."[18]

Taylor cannot, of course, be held responsible for the later misuse of the systems he developed. Nor should we detract from his considerable achievements. The question at issue is whether those achievements included the development and popularisation of novel methods of costing. Contrary to the view expressed by Chen and Pan, the available evidence suggests that they did not.

The First Modern Cost Accounting Book

Chen and Pan conclude their article with a description of Henry Metcalfe's *The Cost of Manufactures* which was first published in 1885. There can be no doubt that this publication was a milestone in the development of cost accounting. Whether it represents "the first modern cost accounting book" as Chen and Pan claim, is however, much less certain. There had been a number of books published in Britain prior to 1885 which dealt with manufacturing cost, but nothing comparable has so far emerged in the United States.

Two books are of particular interest. In 1851 Joseph Sawyer had published privately in London, a small book on bookkeeping for the tanning trade. Despite its specialised nature, it had general relevance, although it is unlikely that it had general appeal. Of more interest, therefore, is a book published in London and Manchester in 1878 by Thomas Battersby entitled *The Perfect Double Entry Book-keeper (Abridged) and the Perfect Prime Cost and Profit Demonstrator for Iron and Brass Founders, Machinists, Engineers, Shipbuilders, Manufacturers, etc.;* it was a modern cost accounting book in every sense. Battersby described the purposes of systems of bookkeeping and costing as:

> Systems of book-keeping and prime cost are indispensably necessary to the successful working of a business. They lie at the foundation of a sound business; they regulate and control all its details, and demonstrate the final result. The system of book-keeping enables a man at any time to know his exact worth, the nature of his assets and liabilities, the gains or losses in detail, and how they arise, the amount of his expense or outlay on any particular undertaking, or under any head of account or branch of busi-

> ness; he can compare his expenditures for similar objects during different periods, and he can analyze the results. . . . It is an effectual check against fraud and errors, which are easily concealed by a defective system.[19]

Six different systems of allocating overhead were described, but Battersby indicated his clear preference for basing the allocation on direct wages. His objection to allocations based on rates for individual tools or labour hours or, as was most common, on prime cost, arose because "as the expenses are not known it is pure assumption."[20] However, he had no such qualms about using direct wages because "wages and indirect expenses stand in relation to one another, the latter is the effect of the former and they *increase* or *decrease* according to the amount of capital employed."[21]

Battersby also saw clearly the connection between the cost records and the financial accounts. The aim, always, was to identify the sources of profit: "It is by no means the least part of the book-keeping to furnish accurate data of the working of each branch of the business and expenses incurred therein."[22] Depreciation, and "periodical adjustments of assets"[23] were provided for in the accounts, and the required return on capital constituted the amount required to be added to "'gross prime cost" in order to determine selling prices that would yield an appropriate profit.[24] The system thus "secured a manufacturer against loss arising from this branch of his business, and it prevents *excess* of profit-extremes equally disastrous in effect."[25]

Battersby commented that he "had peculiar advantages for seeing the various methods of book-keeping and prime cost that are in general use,"[26] and he gave examples in Part II of his book. Other authors writing in Britain during this period also gave examples, or alluded to "practices." Sawyer's book for tanners included examples of cost accounts, but they were not articulated with the financial accounts. Edwards (writing in 1937) referred to authors, such as F. H. Carter, who published a book in 1874, and who described cost systems seen in practice in mines and quarries. In those cases, the "oncost" was added in proportion to the tonnage extracted from each gallery or level.

In the United States there were also examples of books which described costing records and accounts in different industries. Crittenden had described methods of farm accounting in 1860, and included methods of allocating the costs of "farming utensils" and general overhead.[27] Kirkman published a number of books on rail-

road accounting [1877, 1880, 1881, and 1886] which included "divisionalized" accounts, each division bearing its share of "joint expenses."[28] But perhaps the best indication of the general views of the time is given by the American Bell Telephone Co. Ltd. In its *Accounting Circular* of 1884, no reference was made to the allocation of overhead except in the case of salaries; "for instance those of the general manager" were *not* to be charged to new construction. By 1887, there had been a change of view. The circular of that year included instructions for apportioning general expenses "upon the basis of gross earnings of the exchanges."

None of these expositions were as detailed or provided the explicit examples of product costing contained in Metcalfe's book. Nevertheless, it does seem that the ideas were more common than Chen and Pan would allow. But to suggest that Metcalfe's was the first modern cost accounting book is to place an extraordinarily narrow definition on "modern." For Chen and Pan's claim to be correct, even in the United States, it would have to be restricted to engineering products.

Conclusion

It has not been my intention to detract from the contributions of Taylor and Metcalfe. But those contributions must be placed in perspective.

The records and papers which have survived suggest that F. W. Taylor (and his colleagues) understood and implemented many of the new ideas on costing. He sought to forge a link between the cost records and the financial accounts; he developed and explained methods for allocating overhead costs; he used the exception principle, and budgetary control. But he did not confuse the aims of scientific management and cost records. The latter were an appendage. They were necessary for pricing, tendering and identifying profitable lines. They could be maintained by the "planning department" because the originating documents were the same.

It is doubtful if Taylor paid much attention to cost records outside his own companies. He was a vocal and persuasive advocate of scientific management, yet he was strangely silent about costing. Accordingly, accounting history has done him the justice he deserves. He did not publicize his costing methods, and there was little in them that he could have claimed to be original. In those respects Chen and Pan's claims cannot be sustained.

Similarly, while the importance of Metcalfe's book cannot be denied (it ran to several editions), it was not in itself unique. The matters discussed and the methods illustrated within the book were the subject of much discussion at that time.

As I have indicated elsewhere,[29] the unique setting of the mechanical engineers in and around New York from 1879 onwards provided the greatest boost to the development of cost records and eventually of cost accounting. Taylor and Metcalfe were active members of that group of mechanical engineers. They made very significant contributions not only to scientific management, but also to cost accounting. The point of this comment is that they were not alone in those contributions. Their activities must be seen in the context of the time and of their contemporaries if we are to evaluate fairly their respective roles.

FOOTNOTES

[1]Chen and Pan, "Frederick Winslow Taylor's Contributions to Cost Accounting."
[2]Chen and Pan, p. 1.
[3]Taylor, "Bookkeeping under the Taylor System," p. 2.
[4]Chen and Pan, p. 1.
[5]Wells, *Accounting for Common Costs,* p. 98.
[6]Chen and Pan, p. 2.
[7]Taylor, Comments on "Shop-Order System of Accounts," p. 475.
[8]Metcalfe, "The Shop-Order System of Accounts," p. 487.
[9]This heading, and the discussion which follows are taken from Wells, *Accounting for Common Costs,* pp. 97-102. The historical references are taken from Wells, *A Bibliography of Cost Accounting: Its Origins and Development to 1914.*
[10]Chapman, "Accounting in Relation to Economic Problems," p. 623.
[11]Kendall, "Unsystematized, Systematized and Scientific Management," p. 105.
[12]Taylor, "Cost Keeping under the Taylor System of Shop Management," p. 1.
[13]Evans (1910), p. 878 and (1911), p. 7.
[14]Taylor, "Cost Keeping under the Taylor System of Shop Management," p. 1.
[15]Evans, *Cost Keeping and Scientific Management,* p. 23.
[16]Evans, "The Importance of Accurate Costs," p. 167.
[17]Church, *The Science and Practice of Management,* p. 478.
[18]Church, *The Science and Practice of Management,* p. 478.
[19]Battersby, "The Perfect Double Entry . . .," p. 4.
[20]Battersby, "The Perfect Double Entry . . .," p. 36.
[21]Battersby, "The Perfect Double Entry . . .," p. 36.
[22]Battersby, "The Perfect Double Entry . . .," p. 31.
[23]Battersby, "The Perfect Double Entry . . .," p. 29.
[24]Battersby, "The Perfect Double Entry . . .," p. 36.
[25]Battersby, "The Perfect Double Entry . . .," p. 33.
[26]Battersby, Preface.
[27]Crittenden, *An Inductive and Practical Treatise on Bookkeeping by Single & Double Entry,* p. 43.
[28]Kirkman, *Handbook of Railway Expenditures,* p. 108.

[29]Wells, *Accounting for Common Costs,* pp. 62-70, and in the Introduction to Wells, *American Engineers' Contributions to Cost Accounting.*

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BOOK REVIEWS

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Carl Thomas Devine, *Inventory Valuation and Periodic Income* (New York: The Ronald Press Company, 1942. Reprint edition, New York: Arno Press, 1980, pp. vii, 195, $19.00).

Reviewed by
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It is tempting, but unfair, to start a review by describing this book as containing more than anyone would ever want to know about inventories. Professor Devine identifies his objective in writing the book as an "investigation into the effects of various inventory valuation methods on the reported income stream." (p. iii) These "various inventory valuation methods" include Identified-Unit Cost, FIFO, Weighted Average, Moving Average, Standard Costs, Replacement Costs, Lower of Cost or Market, Normal Stock Methods (including LIFO), and Inventories at Selling Price.

Within the context of the literature of the period, Professor Devine does much more than examine the effect of these methods on income. The first chapter is an overview of accounting income theory and chapter two is a description of the nature of accounting inventory costing. In chapter three, Devine discusses balance sheet considerations of inventory valuation. Chapter four, "Costs and Their Determination," contains, as a part of the discussion of cost determination, a section on the appropriateness of capitalizing interest. I found this section to be a more objective evaluation of the controversy than is found in contemporary literature. The chapter on Replacement Costs is a summary of the various positions on replacement cost accounting current at that time. Chapter eleven, "Inventories at Selling Prices," is an interesting interpretation of revenue recognition. The highlight of chapter twelve, "Special Problems in Inventory Valuation," is a discussion of the economics of hedging and the accounting treatment of hedging contracts.

This book is not easy to read. By contemporary standards much of the analysis is trivial and one's mind tends to wander. If, however, the book is put in its proper historical perspective, then the book must be viewed differently. The book reflects the change in emphasis from the balance sheet to the income statement that had started taking place a few years earlier and was common by the date of publication. This shift in emphasis combined with income tax laws surely was the reason that accountants developed several new cost flow assumptions for inventory cost determination (primarily base stock methods). The rationales supporting these methods were still very useful tools for the accountant when attempting to explain his position. Hence, Devine provides us with very detailed arguments that we never hear or see anymore for various cost flow assumptions.

The short, two-page preface is the most interesting section of the book for me. Here Devine reveals that he is wrestling with the problem of criteria for the evaluation of accounting policy. Another transition in accounting thought is reflected here. But rather than writing during the final stage of change as he was with the change of emphasis to the income statement, he is at some intermediate stage in the shift of thought. Specifically, Devine is writing during that rather long transition period when emphasis in the literature is shifting from practitioner and management use of statements to consideration of the perceived needs of external users. He states:

> The method employed somewhat imperfectly throughout this work for testing the desirability of various proposals may be divided into three more or less independent phases. First, an attempt is made to determine the possible consequences of each course of action. This stage is given considerably more emphasis than either or both of the others. Second, an estimate of the probable reactions of those reading the accounting reports is made. These estimates admit a great deal of inexactness, because at various points the evidence is not sufficient to support clear-cut judgments. Third, the desirability of the probable reactions is tested by reference to certain broad social standards taken from the general fields of business administration, economics, sociology, and psychology. (p. iv)

I don't think anybody would be surprised that Professor Devine was not able to apply these criteria with much success. The results of his efforts are intricate verbal descriptions of how the absolute

income numbers and the income time series might be affected by the selection of each of the inventory methods and an empirical examination of how the various inventory methods affect the income of certain organizations. Professor Devine's criteria are not operational and his empirical efforts are very primitive, yet this and other similar works of the next few years are the foundation upon which contemporary academic research is built.

Professor Devine's concern for the development of criteria for the evaluation of accounting choice certainly did not end with the publication of *Inventory Valuation and Periodic Income.* Some years later, he prepared the manuscript, "Research Methodology and Accounting Theory Formulation," [1960] for *The Accounting Review* dealing with the same problem.

Earlier I indicated that the book is rather hard reading because it is concerned with the type of reasoning that is rarely used (successfully) in the literature today. One may properly infer, then, that the book is of little interest outside of the context of the development of accounting thought. Even then, if one is seeking a general knowledge of accounting thought in the second quarter of the twentieth century, the book should not be near the top of the reading list. Devine relied very heavily on Paton's work and Gilman's *Accounting Concepts of Profit* [1939]. Certainly, almost anything by Paton and Gilman's work should have higher priority than *Inventory Valuation and Periodic Income.*

For certain types of work, the book is important. I would recommend it for someone concentrating on a chronological period as broad as from 1938 through 1950 or for someone working on the development of thought on any of the following: inventory accounting, early empiricism, criteria for accounting choice, or income smoothing. Devine anticipates Hepworth's suggestion for smoothing [1953] by eleven years and Gordon's formal statement of the hypothesis as a criterion [1964] by twenty-two years.

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Bruce E. Gelsinger, *Icelandic Enterprise: Commerce and Economy in the Middle Ages* (Columbia, S.C.: University of South Carolina Press, 1981, pp. xix, 299, $19.50).

Reviewed by
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Bruce Gelsinger, in this ambitious work, chronicles the growth of Icelandic civilization within an economic context, by exploring commercial opportunity affecting the island during the Middle Ages. As a specialist in medieval Scandinavian history, the author has amassed an impressive bibliography including both Icelandic and non-Icelandic sources within the primary and secondary works referenced.

The book is divided into three main parts composed of seven chapters, and an Epilogue:

Part One: Icelandic Prerequisites for Foreign Trade
- Chapter One: Environment, Resources, and Material Needs for Medieval Icelanders
- Chapter Two: Icelandic Institutions and Commercial Practices
- Chapter Three: Old Norse Merchant Ships and Navigation

Part Two: Iceland's Commercial World
- Chapter Four: Icelandic Trade with Norway, Denmark and Sweden
- Chapter Five: Icelandic Trade with Other North Atlantic Settlements
- Chapter Six: Icelandic Trade with England, Ireland, and the Continent

Part Three: The Course of Icelandic Foreign Trade: A Summary
- Chapter Seven: Icelandic Foreign Trade

Epilogue: Icelandic Foreign Trade from 1264 to the End of the Middle Ages

The author indicates in the Preface that the documentation for this work was gathered from both written and archaeological sources. The archaeological evidence has been used to corroborate, or clarify where necessary, the written record.

Iceland is a land rich in history. This land of ice and fire, fraught with extensive glaciers and lava fields formed by virulent volcanoes, evokes images of challenge and unremitting hardship for the first settlers who colonized the isolated island. But the island also afforded these colonists wide grasslands and a fairly mild climate.

Driven by political disquiet at home coupled with economic travail due to scarcity of land and, consequently, opportunity, the first significant number of Scandanavian settlers arrived in approximately 870, beginning the Age of Settlement. Unfortunately, despite a brisk colonization period extending through 930, the opportunity for domestic production of certain foodstuffs was limited both because of, and despite, the climate and availability of arable land. Although mild, the climate was yet too harsh for an adequate growing season. The land was best used for grazing. With such domestic incapabilities, the development of foreign trade became an imperative.

The Commonwealth, a term applied to this initial independent age in Iceland's history extends through 1264, and, in general, includes the Age of Settlement. It is a period of commercial development throughout Europe, and the burgeoning trade routes directly impacted Iceland.

As was mentioned before, the fundamental impetus for Icelandic trade was the necessity to import certain commodities unavailable on the island. Initially, this trade was carried on by the Icelanders themselves, probably using the ships which brought them to the island. Principal among the foodstuffs required was grain. In exchange, the Icelandic populace offered various sheep products, particularly a cloth called vathmál, used during this time as both a monetary unit and a commodity, and acceptable as both in foreign trade. The author indicates the value of several goods in relation to vathmál, as well as exchange rates with the accepted base, silver, over time.

The economic interrelationships necessary for the survival of this isolated island illustrate more than just the growth of this small island's foreign trade. The author has included, as a major part of this work, an extensive analysis of trade opportunities throughout the known world available to these Scandinavian settlers during the Middle Ages. What evolves is a fascinating chronicle of a dimly perceived period of exploration, adventure, challenge and daring, all the more fascinating because it was not an unusual attitude during this time. Extensive information included in this work on commercial practices and economic opportunity throughout Europe affords us an overall impression of life during this period, and serves as a backdrop to the difficulties which resulted in the end of the Commonwealth in 1264. One of the most disastrous trends which sparked this event was the loss of Icelandic self-reliance with respect to foreign trade.

Initial success, as Icelandic products became well received abroad by the beginning of the eleventh century, prompted a reliance on Norwegian merchants willing to make the perilous voyage to Iceland, and provide the vessels required for the journey. As a result, most imports were received from, or at least through, Norwegian markets. Such reliance resulted in virtual isolation from active trade, the repercussions of which were felt when internal Norwegian demand for the grain products most needed for import by Iceland increased as supply diminished. At the same time, European demand through Norwegian markets for Icelandic products declined, and other markets were not easily identified or assured. Icelandic trade practice, coupled with a decline in the general food supply, predicated the crisis which resulted in the union with Norway and terminated the Commonwealth.

This work, although not directly related to the history of accounting, is important when considered within a broad evolutionary historical framework. As descendents of Europeans who brought with them trade practices and mores based on the commercial interaction during the Middle Ages, accounting thought and practice (as evidenced today and when considered within the historical perspective) may be derived from this commercial activity.

Edward Thomas Jones, *Jones's English System of Book-Keeping* (London: Privately Printed, 1796. Reprint edition, New York: Arno Press, 1978, irregular pagination, $15.00).

Reviewed by
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Jones's English System of Book-Keeping has probably had more influence than any other single document on the development of double-entry accounting into an integrated system. Rather than making a direct contribution, it has led many critics of this treatise to look at the logic of double-entry accounting and articulate various accounts into a coherent system. (p. 13)

Originally published in 1796 in Bristol, England, it was reprinted in 1978 in New York by Arno Press from the 1796 edition. The current edition begins with an introduction by Professor Basil S. Yamey. In this section, the sequence of events leading to publication in England is discussed. Apparently, its initial publication aroused criticism in England and in other European countries. The introduc-

tion provides the reader with an excellent background and facilitates a better understanding of the book.

Following Professor Yamey's comments is Jones' address "the commercial and trading world." In this section, Jones looks at the business environment and accounting systems of his time. He explains how a successful business enterprise can be transformed into a bankrupt one by a deficient accounting system. Furthermore, he examines some of the bankruptcies of that time and places blame on the single and double-entry systems being used. Finally, he claims that his system of bookkeeping will eliminate the potential of related frauds and business failures.

In the second section of his book, Jones compares the old system to his new one. According to Jones, single entry accounting is simple and easily understood. Further, he views double-entry accounting as complex and obscure and as placing a great reliance on the trial balance to detect any error or fraud. He then argues that if the original entries are not properly recorded and posted, the trial balance becomes meaningless. He rejects existing systems on the grounds that they are susceptible to numerous errors and frauds, a deficiency which is eliminated by his system. He also suggests that his system can be adapted to the double-entry accounting system. Through this adaptation, one can maintain separate accounts for each item and still get the benefit of the accuracy that his system offers. This compromise suggests that Jones has forgotten that he has violently attacked double-entry accounting earlier.

Jones details the mechanics of his system in the third section. The transactions are first entered in one column of the journal in a manner much like that of single entry bookkeeping. The entries from this column are later extended to two additional columns in the same journal; one is a debit column to the left of the original column and the other is a credit column to the right of the original column. The totals of the original middle column must equal the totals of the debit and credit columns. Jones places much emphasis on this procedure to detect error and fraud. These entries are then posted in alphabetically arranged ledger accounts.

Jones suggests that it is useful to periodically reconcile the totals of debits and credits in the ledger against the totals of debits and credits in the journal; these totals must agree at all times. This type of reconciliation was later developed by the double-entry accounting system. He goes on to suggest that statements can be prepared directly from the journal. Some critics believe that the above suggestions constitute Jones's indirect contribution to the development of double-entry accounting. Finally, Jones proposes a plan by which

his system can be taught and he provides an illustration of his system.

A valuable source to those interested in accounting history and in the development of double-entry accounting into a coherent system, this book is also appropriate for use as assigned reading in any undergraduate course where an exposure to the development of double-entry accounting is desired.

Thomas J. Hailstones, *A Guide to Supply-Side Economics* (Richmond: Robert F. Dame, Inc., 1982, pp. 175, $5.95).

Reviewed by
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In the preface to *A Guide to Supply-Side Economics,* Hailstones reveals that he has tried to write a short book for any layman seeking instruction in:

> . . . the classical roots of supply-side economics, the reason for the Keynesian Revolution, the modern setting for supply-side economics, its propositions, its differences and similarities vis-a-vis Keynesian or demand-side management, some models for supply-side economics, its current status and its probable policy applications in the 1980s. (p. v)

The order in which topics are presented is approximately that in the quotation above. Hailstones begins by defining supply-side economics as the general belief that a nation can best promote noninflationary economic growth by stimulating the supply of goods and services rather than the demand for them. (p. 3) Supply-side policies include most prominently lowering marginal tax rates, but can extend to almost any measure that strengthens private incentives to work, save, and invest. If the right micro incentives are in place, the theory goes, the macro economy will be self-sustaining. Thus broadly conceived, supply-side economic theory is as old as the economics profession itself. Hailstones underscores this point by tracing the roots of supply-side thinking to the classical economists of the late 18th and early 19th centuries. The contributions of Smith, Ricardo, and Mill are all discussed together with those of Jean Baptise Say, the patron saint of the supply-side. Appropriately, much of the discussion centers on Say's Law of Markets

which, in paraphrase, states that production generates income which in turn generates demand for the goods produced. If this is true, successful efforts to stimulate supply will not require additional efforts to stimulate demand. As supply expands demand will grow of its own accord preventing inventory accumulation and the threat of unemployment that accompanies it.[1] I say, "If this is true," because Say's Law has provoked a great debate in economics about the conditions necessary for it to hold. Keynes and the demand-siders who march under his banner have pointed to circumstances under which increased supply will not automatically lead to increased sales. These include the existence of "price rigidities" in either the capital or labor market and/or the existence of a liquidity trap in the money market.[2] Hailstones mentions these criticisms in Chapter 3 and then devotes Chapters 4 and 5 to demand-side theory and the history of its adoption in the U.S. The income-expenditure model, on which demand-side economics rests, is developed in much the same manner that it would be in a standard introductory text. The notion that aggregate demand depends upon expenditure decisions of consumers, investors, and the government and that it can be deficient unless somehow "managed" is accurately presented as the keystone of the demand-side point of view.

While the demand-side story is in jarring conflict with the classical arguments previously presented, Hailstones makes no effort to reconcile the two or to choose between them; nor does he indicate the basis on which a reconciliation or choice might be made. This omission is by design and is made to avoid appearing either strongly supportive or strongly critical of supply-side propositions. The result is that the reader is confronted with two opposing but equally plausible sets of arguments. Although scholars will no doubt applaud this objectivity, the layman may wish that his guide provided a bit more guidance. Some data and perhaps a little statistical analysis would have fit the bill nicely here, had it been included. Regrettably, it was not.

The final third of the book develops supply-side economics in its most recent incarnation. Since this is the most timely part of the book, it is fortunate that it is also its strongest portion. In the concluding chapters, Hailstones introduces virtually all of the currently prominent supply-siders, from politicians like Roth and Kemp to academic scribblers like Mundell, Feldstein and Laffer. While the contributions of these and many other individuals are only briefly described, this section is extensively footnoted and followed by an excellent bibliography. The bibliography alone is worth the price of the book, but the last chapters contain much more. Chapter 9, for

instance, covers the Laffer curve and the capital and labor wedge models. One simply cannot understand modern supply-side thinking without an adequate understanding of each of these. Also included is a discussion of the Capital Cost Recovery Act or 10-5-3 plan for accelerated depreciation. Hailstones correctly points out that such a measure is necessary to prevent the underdepreciation of assets that occurs when historical cost accounting methods are applied during inflation. This inflation induced distortion is one of the major problems to face the accounting profession in recent times and it is comforting to see legislators and popular authors finally cognizant of its dangers. The book concludes with a discussion of the current policy status of supply-side ideas and several appendices showing how they have been incorporated in the Reagan Administration's economic program. The appendices are quite thorough and cover everything from specific tax and expenditure cuts to reform of the E.P.A.

In summary, Hailstones has attempted to cover the entire waterfront of supply-side economics for those with an interest but little background. Explaining so much to the uninitiated is a formidable task even when length is not a consideration. If one limits oneself to 175 pages of large print, as Hailstones has, the task is more difficult still. The problem is that 175 pages does not provide enough room to include very much detail. Hailstones realizes as much and obviously cuts everywhere he feels that he safely can. Statistical data, for instance, is generally omitted as is the kind of rigorous critical analysis generaly found in the professional literature. Instead of analysis or detailed exposition, the reader receives the gist of the supply-side story in a readable almost outline format. In short, if one is seeking an introductory or conversational knowledge of supply-side economics, this book provides it. If one is seeking a deeper understanding, further reading is necessary but the book provides a good start.

FOOTNOTES

[1]Keynes, pp. 78-79.
[2]Say, p. 172.

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Reviewed by
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This classic volume was written to provide the practicing accountant with a reference to certain judicial opinions and, accordingly, enable him to research the subject without the need to avail himself of a law library. It was the author's belief that familiarity with the facts and law cited in this work would provide the accountant with a better understanding of professional liability. He believed, also, that knowledge of the past would better enable the accountant to avoid liability in the future. The author indicates that he was prompted to write this volume as a result of interest generated by Chapter 6 of the *CPA Handbook,* the full text of which is reprinted in slightly rearranged form in the volume under review.

The book is divided into two parts. The first, entitled "An Analytical Survey" contains seven chapters. The second part consists of cases and articles, and is divided into six sections. The judicial opinions in a number of landmark cases are reprinted, many in their entirety. Two articles contained in this section were authored by Levy, and a third by John L. Carey.

The seven chapters in the first part address the traditional topics in the area of professional responsibility: fundamental considerations, liability to clients, liability to third parties at common law, liability to third parties by statute, disciplinary proceedings, working papers and privileged communications. Much of the information contained in these chapters is still relevant. However, some of it is out of date, particularly that found in Chapter Four, "Liability to Third Parties By Statute." Liability under the Securities Act of 1933 and the Securities Exchange Act of 1934 constitute the core of this chapter. Section 11(a) and Section 13 of the 1933 Act are discussed, as is Section 18 of the 1934 Act. The author points out that no court cases against accountants had been reported, as of his writing, under the 1933 Act based upon alleged falsity or misleading information as of financial statement dates. The current (1982) reader of this chapter should bear in mind that, due to the almost thirty years elapsing since it was written, the information contained therein is dated. The profession has seen a number of cases during the litigious period since the mid-nineteen sixties. Some of the more

recent ones have been brought under Section 10(b) of the 1934 Act. This section is not even discussed in Chapter Four.

Part Two of the book consists primarily of reprints of judicial decisions, presented in the same topic order as are the chapters in Part One. The three articles in this section are commended to the reader.

This outstanding work is a classic in the area of accountants' professional liability. It is the intuitive belief of this reviewer that it ranked along with Cooley's *Torts* as an authoritative pronouncement. It probably served its intended purpose well for many years but, due to the lapse of time since its publication, the accounting practitioner should today consider it more from the point of view of background material rather than current legal authority. The accountant with a legal problem today is well served to seek counsel immediately. This work should be of considerable interest to historians, both accountants and attorneys. It is a classic.

Graham Mee, *Aristocratic Enterprise* (Glasgow and London: Blackie, 1975, pp. xvii, 222, £5.95).

Reviewed by
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During the period, 1795-1857, the 4th and 5th Earls Fitzwilliam were owners of Wentworth Woodhouse, "a palatial setting for the grand occasion and for the annual gathering of the aristocracy for the Doncaster races." Not content with adopting the role of racing rentiers, the Fitzwilliams singlemindedly exploited the resources of the estate; they expanded the coal mining operations, established (but soon afterwards closed down) a coal tar works and, albeit reluctantly, took over the working of the Ilescar Ironwarks when the lessee went bankrupt in 1827. Dr. Mee's book is a case study of the estate during the period. He tries to ascertain why the Fitzwilliams became entrepreneurs, examines the problems posed by adoption of the entrepreneurial role during the middle years of the Industrial Revolution, and analyses the responses of the Fitzwilliams and their managers to the technical, marketing, financial and social challenges presented by estate management.

Although it is a business history, much light is cast on matters of social interest. The assumption that life in the pits was necessarily one of unrelieved gloom and hardship is given the lie by Mee's

analysis of working conditions and welfare provisions at Wentworth. Not only was the moral philosophy of the Fitzwilliams conducive to the provision of many "comforts and advantages" for the workers, but they were fortunate too in the choice of Benjamin Biram as Superintendent. Biram's contribution to a safe and healthy workplace is well documented by Mee, who writes as clearly about technical aspects of centrifugal fans, rotating vane anemometers, the Biram safety lamp and Fourdrinier's apparatus as about the more mundane, but equally vital, provisions made for widows' pensions, schools and medical care.

The account of the 5th Earl's reaction to trade unionism following the founding of the Miners Association at Wakefield in 1842 is of topical as well as historical interest. There had been unrest before, but faced with growing union membership and collective action, the Earl closed the collieries, only reopening them when all his miners had resigned from the union "obedient to the command of their master." Mee persuasively sides with J. S. Mill, arguing that such a response was perfectly compatible with—indeed, a part of—the paternalism exhibited elsewhere.

Such paternalism is, however, unlikely to explain the 5th Earl's insistence on drawing up his own balance sheet and the reluctance to delegate below senior managers "particularly in what was regarded as the primary management function of accounting." Many managers had great difficulty in submitting regular accounts and extravagance and confused accounts appear to have been a perennial problem. The auditor—a barrister—frequently expressed concern over waste and extravagance and saw it as part of his job, on one occasion, to exhort the Earl to order heads of department to reduce expenditure by 10 or 12 percent, and to appoint a "properly qualified" person to exercise financial management. Much use is made throughout the book of quotations from correspondence, diaries and the like, but the most memorable must be the auditor's reproach, "Economical reform, really so necessary, should be mainly applied to Mr. Biram's book. It is quite true that I have no knowledge of the Details of which this is composed and therefore cannot speak with the slightest authority."

Although Mee refers frequently to the problems with the accounts the accounting historian is likely to be disappointed with the analysis given. At one point Mee writes, "The collieries, ironworks and tarworks all inherited the master and steward system of accounting which was traditionally used by agents on landed estates. The accounts were therefore based on double entry bookkeeping and had a debit or charge side and a credit or discharge side." This apparent

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confusion between the traditional Charge and Discharge and double entry is never fully resolved. There are some interesting illustrations of the practice of charging interest on "capital expended" and of opportunity costing, and an attempt is made to strike a net surplus cash flow for the period, but there is little to tell us why accounting seems to have caused such problems or, for example, for what "sinister practices" the ironworks' bookkeeper was dismissed. Several managers were rewarded by commission based on profits (giving rise to complaints about transfer prices and the charging of "extraordinary" items), but it does not clearly emerge how annual profits were determined. It is suggested that losses at the ironworks were "almost certainly" the difference between total receipts and payments, but as a general principle this would have been unsophisticated even by the standards of some thirteenth century estates. And a footnote dismissing Spring's observation (that the collieries were profitable for only four years between 1830 and 1850) as being "only tenable if one accepts a highly questionable definition of profit used on the Wentworth estate" teases more than it informs.

To be fair, the book is not directed towards accounting historians but rather towards students of management and industrial history and as such should prove a useful study of the paternalistic approach. It is not to denigrate the book to say that its approach is scarcely that of the scholarly treatise; rather, its unassuming style, often in the form of telling a story, is one of its principal qualities.

Michael T. O'Neill, Editor, *A. P. Richardson: The Ethics of a Humanist* (New York: Arno Press, 1980, irregular pagination, $25.00).

Reviewed by
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It has seemed to me that reviewing a book is often looked upon as a distasteful chore; one, however, that is necessary to a profession. For, in this way many professional readers could learn from one reviewer what new material that reviewer considers worth reading. But, the material in this book is not new; and reviewing the book was not a chore—fact of the matter, it was a delightful assignment.

Divided into two major sections, the book deals with two distinct subjects: better writing, called "This Blessed Language," and understanding ethics, titled "The Ethics of a Profession."

"This Blessed Language," a group of 50 essays on writing good English, was originally printed in the *Journal of Accountancy* from April 1939 to January 1943, on a monthly basis, and off and on from then until March 1944. "The Ethics of a Profession," printed in 1931 by the American Institute of Accountants, brought together for the first time in the profession's history, a learned discussion of why the professional needed ethical standards.

Concerning "This Blessed Language," the editor of the book says: "Richardson is aware of the stilted, formulaic style often found in business correspondence and urges instead sentences that are 'brief, clear and euphonious.' " The principles for good writing, copiously illustrated, are just as applicable today as they were when he wrote the essays. Every now and then, while reading the essays, you will say to yourself: "Why haven't I thought of this before?" I believe that if one reads and rereads the essays, many of the stated principles will help to improve one's writing ability.

But, probably more important than only helping a teacher, the book can also be a help to his students. Almost every one of us has heard from practitioners that one of the greatest faults of our educational process is the inability of students to write proper English. Since the essays are so delightful to read, I can see these essays being used as a valuable resource for students who may have some difficulty in writing. For, as I have said before, the basic principles apply today just as much as they did forty years ago.

The section, "The Ethics of a Profession," however, probably can be used better in a classroom than the section, "This Blessed Language." Richardson discusses, in a fascinating manner, just why ethical standards should be applied in the profession of accounting. Through the use of a young accountant as his hero, he explains why this young accountant should follow ethical standards. This section could be valuable reading material for graduate students in an auditing theory class or as a part of an undergraduate course dealing with ethics in auditing. The editor, Michael T. O'Neill, says: "Of the twelve ethical rules cited by Richardson in his 1931 *Ethics of a Profession,* the AICPA standards today still embody seven of them almost in the same language as the 1931 version." Maybe Richardson did understand ethical standards after all.

By the way, do not forget to read the editor's introduction to the man, Alphyon Perry Richardson, and his works. This introduction will help you understand why this man's work was chosen as a classic to be reproduced for later generations.

R. H. Parker, Editor, *Bibliographies for Accounting Historians* (New York: Arno Press, 1980, irregular pagination, $30.00).

Reviewed by
R. Eugene Bryson, Jr.
University of Alabama in Huntsville

This book is a recent addition to the Arno Press collection entitled *Dimensions of Accounting Theory and Practice.* The purpose of this volume is to provide accounting historians with an essential research tool: the bibliography. Reproduced here are eight bibliographies which have long been out of print or otherwise difficult to obtain. In addition, a previously unpublished bibliography by the editor is included.

Due to the language problem, three of the bibliographies in this volume will be of limited value to many researchers. J. Hagers' *Bouwstoffen Voor de Geschiedenis van het boekhouden in de Nederland* (Materials for the History of Bookkeeping in the Netherlands) is a bibliography of pre-20th century materials in Dutch. A more recent bibliography, *Zur Geschichte der Rechnungslegung im engeren deutschsprachigen Raum* (on the History of Accounting in German-speaking countries), is basically a catalogue of bookkeeping texts and accounting records. Gonzalez Fernando's *Bibliographia* covers mainly pre-20th century accounting history and includes items in Italian, English, Spanish, French, Polish, Portuguese, German, Dutch, Czech, and Latin.

Two bibliographies by H. W. Thompson (a former Librarian of the Institute of Chartered Accountants in England and Wales) list books on accounting in English, published between 1543 and 1800, as well as books in other languages covering the period 1494-1750. The coverage of this pair of compilations is remarkably extensive, including, for example, all of the known works of Luca Pacioli.

The remainder of Parker's book consists of four bibliographies printed entirely in English. The annotated bibliography by Marc J. and Joanne B. Epstein is unique in that it is specialized, listing only works dealing with the relationship between scientific management and standard costing prior to 1920. The other three selections represent an attempt by the editor to provide an updated bibliography on all aspects of accounting history. The last item in the book takes the bibliography to 1979.

This book will be beneficial to students of all aspects of accounting history and should be a "must" for any university library. The

recognition of the need for more specialized bibliographies is particularly welcome.

William Andrew Paton and Russell Alger Stevenson, *Principles of Accounting* (New York: The Macmillan Company, 1918, Reprint ed. New York: Arno Press, 1978, pp. xviii, 685, $49.00).

Reviewed by
Dale Buckmaster
University of Delaware

This book represents an ambitious effort by two assistant professors, one at the University of Michigan (Paton) and one at the University of Iowa (Stevenson). I trust that the book made a significant contribution towards their promotion. Paton and Stevenson were writing a textbook, and they make it clear that they feel their objective was to provide the student with the opportunity to understand accounting rather than to demonstrate existing methodologies for the treatment of specialized problems. Illustrative journal entries are sparse, but adequate, and ideas are plentiful. Contemporary textbook writers would do well to emulate their style. The book being reviewed represents the third version of *Principles of Accounting*. Zeff [1979] has described the development of the three versions with the following evaluative comment:

> The 1917 and 1918 versions are not designated as second and third editions, although the titles are identical. Of the three versions, the one published in 1918 is by far the best known—indeed, few citations to its predecessors may be found in the literature. The successive versions grew steadily from 222 pages to 373 and finally 685 pages, reflecting, among other things, the authors' expansiveness and increasing conviction of the rightness of their controversial conclusions. (p. 93).

This edition of *Principles of Accounting* represents an attempt to provide a rather comprehensive coverage of accounting problems of the first quarter of the twentieth century. Paton and Stevenson have divided it into an Introduction and six parts. The Introduction contains a definition of accounting, a description of the economic environment creating the need for accounting, and the function of accounting within that environment. Part One, Elements of Accounting, is a development of the basic ideas of accounting and the data accumulation methods that are equivalent to the material that now

normally constitutes the content of a first college course in accounting. However, the great detail that we normally find now is missing. Emphasis is on ideas.

Part Two, The Equity Accounts, consists of a description of equity accounting for proprietorships, partnerships, and corporations plus a chapter on liabilities. We find the equivalent of Part Three, The Interest Problem, in contemporary Intermediate Accounting. There is a discussion of interest and types of debt, an extensive treatment of present value and annuities, and descriptions of accounting for interest on debt and from investments.

Many will find Part Four, The Valuation of Assets, most interesting. For example, Chapter XX, The Basis for Revaluation, contains the following subheadings:

The General Significance of Value Changes
Valuation and Management
The Measurement of Investment or Sacrifice
Special Objections to the Recognition of Appreciation

The title of Part Five, The Construction and Analysis of Financial Statements, is descriptive of this four-chapter section.

The last part of the text of the book is Part Six, Special Fields of Accounting. Each of the four chapters is an overview of a topic not covered in earlier chapters. The topics are Cost Accounting, Municipal Accounting, Railroad Accounting, and Auditing.

I am incapable of determining the role of this book in the development of accounting thought. If one is to do this, it is crucial that a judgment be made of the degree to which the book is representative of accounting thought of the time and the degree to which unorthodox ideas are advanced. I cannot make this judgment because I lack the requisite breadth of knowledge of early twentieth century accounting thought. Zeff [1979] indicates, however, that:

> It is no surprise that in the first significant period of his writings, 1917-1918, Paton emerged as an idealist. Accounting writers are inclined to cite his 1918 textbook, *Principles of Accounting,* which he wrote with Russell A. Stevenson, as his most uncompromising challenge to accounting orthodoxy. And it was. (pp. 91-92).

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Zeff, Stephen A., "Paton on the Effects of Changing Prices on Accounting, 1916-55," in Stephen A. Zeff, Joel Demski, and Nicholas Dopuch, eds. *Essays in Honor of William A. Paton: Pioneer Accounting Theorist* (Ann Arbor, Mich.: Graduate School of Business Administration, The University of Michigan, 1979), pp. 91-138.

Glenn Porter, *The Rise of Big Business, 1860-1910* (Arlington Heights, Ill.: AHM Publishing Corporation, 1973, pp. xi, 119, $4.95).

Reviewed by
Tom McInish
University of Texas at Arlington

What is "big business"? The author of this short but informative book spends 27 pages explaining why big business is not simply a large version of small business. Not only does big business have more capital than small business; but there are many other more fundamental differences: higher fixed costs, greater separation of ownership and control, and more diverse economic functions. The importance of each of these is explained in detail in this first chapter, devoted to the meaning of the phrase "big business." Another difference is the way the control of distant operations is handled. Small firms such as merchant bankers had traditionally solved the problem of insuring accountability and honesty by staffing distant branches with relatives, but large firms must rely on organizational controls. The most important consequence of the unique characteristics of big business for accountants is that they give rise to the need for complex managerial structures. This complexity leads directly to an increased reliance on the accounting profession.

Altogether very enjoyable reading, the book is enhanced by its numerous references to other works and to specific industries and companies. There is also an excellent annotated bibliography. The book would be useful to accounting students in that it clearly explains the origins of the increased role and status of the accounting profession in modern society. The first chapter on the meaning of "big business" is followed by one which describes the rise and spread of big business. The third and last chapter explores the impact of big business on society.

C. Joseph Pusateri, Editor, *Big Business in America: Attack and Defense* (Itasca, Illinois: F. E. Peacock Publishers, Inc., 1975, pp. 192, $3.95).

Reviewed by
Martha K. Farmer
Augusta College

Big Business in America was written as a part of a series called "Primary Sources in American History" which, according to the

series editor, Grady McWhiney, "provides the documents necessary to explore the past through the eyes of those who lived it." A wide range of topics is covered by the series. The expected use of *Big Business in America* was the college classroom, and as such presents the chronological development of big business,.

This book is divided into three sections, each of which presents a major stage in the development of huge business organizations. In the introduction, Pusateri presents what he calls "the dilemma of abundance." This dilemma is not resolved and the reader is left to ponder the compatibility of "classic American values" with "big business." The author does not take a position, but clearly presents the historical developments surrounding various attempts to provide solutions. The author's desire to provide students with an "appreciation of the complexity of the challenge of modern large-scale business enterprise coexisting with the time-honored values and ideals born of an earlier, less troublesome America" is definitely achieved. His method of presentation provides history without bias.

Part I, "The Emergence of a Dilemma" consists of a case study of Standard Oil. The reader is exposed to the details of operations, court challenges, and investigations. It is obvious that a dilemma does exist when these situations are considered.

In Part II, the Dilemma is presented as a political issue. The Sherman Antitrust Act is the foundation for a political policy. The entire act is quoted along with reports of subsequent investigative agencies. By reading the complete document, one develops an appreciation for the complexity of the problems embodied in the Dilemma and the tentativeness of apparent solutions. The enforcement policies of Theodore Roosevelt, Woodrow Wilson, Herbert Hoover, Calvin Coolidge, William Harding, and Franklin Roosevelt are presented. The essence of all enforcement philosophy is embodied in Franklin Roosevelt's actions. In the early years of his administration, the emphasis was on national planning with little hindrance to cooperation between firms. In 1930, Roosevelt appointed Thurman Arnold to head the Antitrust Division of the Justice Department. Arnold doubled the size of that Division within a year. In 1942, big business won again as Roosevelt agreed to permit the postponement of antitrust prosecutions, at the discretion of the Secretary of War.

The final section of this book presents the historical development of "The Military-Industrial Complex," "The Social Responsibility of Business," and "Multinationalism." Throughout the book, case studies of large corporations provide interesting insight into the problems of big business. Just as important are the hearings and

committee reports which present the evils of bigness. Pusateri has done an excellent job of maintaining a balance of information so that this book is neither for nor against big business. It is what it is intended to be: a history book which traces the development of big business and presents this development through the eyes of those who lived it.

Wiley Daniel Rich, *Legal Responsibilities and Rights of Public Accountants* (New York: American Institute Publishing Co., Inc., 1935, Reprint ed. New York: Arno Press, 1980, pp. xii, 236, $22.00).

Reviewed by
Charles L. Holley
Virginia Commonwealth University

This book is a comprehensive treatment of case and statutory law applicable primarily to public accountants. The first chapter describes the public accountant's liability for negligence, libel and fraud. The three remaining chapters involve the law relative to the public accountant's certificate, the accountant as an expert witness and certain special rights of public accountants. Copyrighted in 1935 and reprinted in 1980, this reference contains 222 pages of narrative, an Appendix (AICPA Rules of Professional Conduct in 1935), a table of legal cases cited (5 pages), and a bibliography.

Chapter I (Liability of the Public Accountant for Negligence, Fraud and Libel) describes the development of laws relative to public accountancy according to the following main divisions:

I. Interest in the public accountant's liability for negligence and fraud.
II. Nature of negligence.
III. Liability of the public accountant to his client for negligence.
IV. Liability of the public accountant to his client for libel.
V. Liability of the public accountant to third parties for negligence and fraud.
VI. Extension of the ambit of negligence rather than that of fraud to cover the public accountant's liability to third parties for innocent but negligent misrepresentation.
VII. Criminal liability of the public accountant for fraud.

There are extensive quotations from court cases to emphasize the most important issues. Chapter I alone contains 97 footnotes for legal sources, explanatory material, and supporting periodical arti-

cles. There are two hundred eighty-four footnotes throughout the book.

Chapter II (Law and the Certified Public Accountant's Certificate) describes legal issues pertaining to the certification process. The background of many state certification requirements is presented with the legal implications of issues such as reciprocal certificates, memberships in professional accounting organizations, cancellation and reissuance of certificates. Court cases are also cited extensively throughout this chapter. The author's interpretations and predictive views make this an interesting chapter. For example, Rich writes "In view of the present political, social and economic conditions demanding greater control of private business, it is probable that the United States supreme court would uphold a statute restricting the practice of public accounting to those certified." (p. 141).

Chapter III (The Admissibility of the Public Accountant's Expert Testimony in Court) is an excellent presentation of background material on expert testimony in general and the admissibility of accountant's and auditor's expert testimony in court. English and American law is cited throughout the chapter. Chapter subdivisions also include custody of records, authenticity of records, confidential communications, and primary versus secondary evidence.

Chapter IV (Some Special Rights of Public Accountants) is the shortest (30 pages) chapter and includes the following topics: champerty, ownership of working papers, liens upon employer's books, rights under bankruptcy law, recoverability of auditor's expenses, and the rights of practitioners of public accountancy to incorporate. The section on ownership of working papers is especially informative and currently very relevant.

This book was originally presented as the author's thesis at Columbia University. It is well written, covers diverse technical topics, and cites many court cases. However, it requires careful attention by the reader. This book would be appropriate as one reference in graduate courses such as auditing, the environment of accounting, and history of accounting. It belongs in every university library.

William G. Shenkir, Editor, *Carman G. Blough: His Professional Career and Accounting Thought* (New York: Arno Press, 1978, irregular pagination, $31.00).

Reviewed by
Clifford D. Brown
Northern Arizona University

It is a great honor for me to review the selected writings of a man who has an unparalleled influence on the development of accounting principles and auditing procedures in the United States. Dr. Blough's eminence is evidenced at the beginning of the volume by three short testimonials which serve as an introduction to the man, his credentials, and his honors and accomplishments. The remainder of the volume contains twenty-eight of Carman Blough's addresses and articles, arranged in chronological order, starting in 1937 when he served as the first Chief Accountant of the Securities and Exchange Commission.

The first item ought to be viewed as a classic and required reading for accounting history students (and faculty). It was a 1937 address before a large group of CPAs in New York City. In that address, Blough outlined the vast variety of inconsistent accounting practices found in SEC filings that were considered "GAAP" by the registrants. In addition to citing numerous examples of inconsistent practices, he also placed the accounting profession on notice with regard to the need for its members to improve the current state of accounting and reporting practices. If the profession did not respond and initiate steps to promote improvement, then the Commission had the authority to "undertake the prescription of principles." I believe this speech to be classic, not only because it serves as a bench mark to assess the progress that has occurred in financial reporting over the last forty-five years, but also because it prompted the American Institute (AICPA) to establish the Committee on Accounting Procedure. We have never been so close to having the standard-setting process transferred to the public sector. Without that speech and subsequent actions it evoked, financial accounting and the profession might be significantly different.

Other articles in this collection focused on a wide variety of subjects. Each article, however, reflects Carman Blough's unending crusade for improvement in accounting and auditing practices. For example, there are selections reflecting his concern as to the meaning of financial statements and the responsibilities of both the auditor and management. In reading these selections, correspond-

ence to today's concerns is apparent. For example, in one 1938 article appearing in *The Controller,* Blough expressed a concern that some of the "comprehensive footnotes" accompanying financial statements in recent years "may be made to confuse rather than to assist the investor." In another 1939 address at the Central States Accounting Convention he stated that "A corporation has a definite responsibility for the statements it presents and has no right, . . . to publish them unless it presents them as its own." This statement is directly applicable to the current requirement that management must state its responsibility for the integrity of the financial data in the annual report.

Many of the other articles and addresses in this volume highlight Blough's efforts as a member of the Committee on Accounting Procedure, as Director of Research of the AICPA for sixteen years, and as a member of the Accounting Principles Board. In fact, nineteen of the articles are selections from those sixteen years when he was Director of Research. The subject matter of these nineteen selections not only related to specific technical accounting and auditing matters that were being considered by the AICPA's official committees at the time, but also reflected Blough's views toward the role of research in the standard-setting process and his concern that standards promulgated be based on sound theoretical underpinnings. Many of those selections would also be suitable as required reading in many financial accounting and auditing courses at both the undergraduate and graduate levels. For example, the article "Auditing Standards and Procedures" is an excellent introduction to the distinction between auditing standards and auditing procedures, and would enrich any auditing course. Two other selections entitled "Responsibility to Third Parties" and "Current Developments in Accounting and Auditing" would also be appropriate for auditing courses. Other articles such as, "Can Conventional Accounting Cope With Inflation," "Depreciation—To Measure Income or to Provide Funds For Replacement?," and "Accounting Research for Better Financial Reporting" all would enhance financial accounting courses by adding the much needed historical perspective. In addition, "Nine Ways to Render an Annual Report More Useful to Stockholders" and "The Meaning of Generally Accepted Accounting Principles" are two examples that would be very appropriate for even elementary courses.

A common denominator in all his addresses and writings in this volume is his unwearied and unyielding efforts to improve (and to see improved) the current state of financial reporting. Those who today question "improvement" or "lack of improvement" in financial

reporting need only read the last article in this collection entitled "The Past is Prologue" to gain an appreciation for current financial reporting. Blough refers to a 1921 effort to secure rudimentary sales, cost, and non-operating income data from thirty companies. He stated this effort "brought very little information, . . . forty percent did not answer at all . . . and about another forty percent replied that the information was confidential and could not be disclosed." To see and to be a cogent force in a transformation from that situation to the current state of financial reporting must be very gratifying.

In addition to specific selections referred to above, the entire collection could be used to introduce students to what milestones in a full career really mean, and to serve as a reminder to contemporary accountants of one man's immeasurable influence and service to the accounting profession. One of the saddening events of 1981 was the death on March 9 of Carman Blough.

T[homas] B[ond] Sprague, *A Treatis on Life Insurance Accounts,* and *A Treatise on Insurance Companies' Accounts* [Revised by A. E. Sprague], (London: Charles & Edwin Layton, 1874/1911, 1874 ed. pp. 158, xxiii, 1911 ed. pp. 100, vi; Reprint ed., two vols. in one. New York: Arno Press, 1980, $24.00).

Reviewed by
Robert B. Yahr
Marquette University

This book is a reprint of two earlier books describing the impact of two United Kingdom legislative acts—the 1870 Life Assurance Companies Act and the 1909 Assurance Companies' Act—on life insurance company financial reporting. The first book was authored by T. B. Sprague, a president of the Institute of Actuaries; the second book, a revision of the first, was prepared by his son, A. E. Sprague. The primary purpose of each edition was to explain the function of the several financial statements required by each act and to describe the principles of accounting underlying those required statements.

Although British accounting in 1870 was more advanced than it was in the United States, financial reporting in general was in its infancy at that time, with financial reports usually limited to summaries of cash transactions. The 1870 Act was designed to establish a set of uniform statements which would more accurately reflect the

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financial position of life insurance companies. The 1909 Act revised some of these statements by clarifying parts of the earlier act and by expanding the amount of information required.

In recognition of the intentions of these acts, the authors begin each edition by explaining the differences between a cash account (a statement summarizing cash transactions) and the required "revenue account" (a statement similar to the modern income statement). They also illustrate the effects of using a cash account on the analysis of financial relationships. After differences between cash and revenue accounts are explained, the remainder of each edition is devoted to explanations of the required financial statements and each item which should appear thereon.

The authors' discussions in both editions continually emphasize the need for uniform financial reporting. One extension of this emphasis on uniformity forms in this reviewer's mind the most interesting aspect of the first edition. As an outgrowth of analyzing each company's 1871 annual report, T. B. Sprague intersperses citations of actual deficiencies in the various companies' reports within his analysis of the Act's requirements. For example, in his discussion of "Mortgages on Property within the United Kingdom" (pp. 66-74), he describes the items the 1870 Act requires under this heading and then indicates 103 instances where companies have failed to classify properly some of their holdings. This meticulous analysis typifies the care that he took in writing the entire first edition.

The first edition very accurately portrays the status of financial reporting immediately after passage of the 1870 Act. It also serves to provide a reader familiar with the history of life insurance reporting in the United States with a greater understanding of the background behind the adoption of certain accounting principles for American companies. The second edition, while not containing all the detail of the first, adequately explains the revisions to financial reporting mandated by the 1909 Act.

Both the first and second editions contained in this reprint book are recommended for individuals having an interest in either financial reporting for life insurance companies or the development of accounting in the United Kingdom.

Howard F. Stettler, Editor, *Auditing Symposium III — Proceedings of the 1976 Touche Ross/University of Kansas Symposium on Auditing Problems* (Lawrence, Kansas: University of Kansas Printing Service, 1976, pp. 135, $5.00).

Reviewed by
James D. Blum
American Institute of Certified Public Accountants

Auditing Symposium III includes eight invited papers and seven discussants' responses presented at the Touche Ross/University of Kansas third biennial auditing symposia for practitioners and educators. The objective of the symposium is to bring practitioners and educators together to discuss contemporary auditing issues. The papers are not rigorous research reports, but rather descriptive reports of the state of the art as practiced or presented in the literature, and/or opinions of the practitioners as to what constitutes the state of the art. Thus, the proceedings via the papers and discussants' responses probably assisted both academicians and practitioners in gaining insight into the literature and practice relating to contemporary auditing issues.

As in past symposia, the first paper, "An Auditing Perspective of the Historical Development of Internal Control," is a part of Professor Stettler's attempt to assemble a series of papers that might eventually provide a comprehensive dissertation on the development and heritage of auditing. In this first paper, Willie Hackett and Sybil C. Mobley review the findings of accounting historians that have studied the historical development of internal control. They start with the Mesopotamian civilization, revealing how separation of duties existed, and how tiny tick marks, etc. at the side of figures indicated that checking of transactions had been performed. Hackett and Mobley rapidly summarize the historical development of internal control and then focus on the conceptual development of internal control by tracing terminology and descriptions of internal control and auditing in the various editions (first through the ninth) of *Montgomery's Auditing*. As the discussant, Rodney J. Anderson, correctly concludes:

> In summary, I thought the paper gave an interesting overview of the historical development. As in all overviews, it is something that could also be expanded—and indeed, might be of considerable interest in a more expanded form. (page 15)

In "Management Behavior—An Auditing Horizon," W. Donald Georgen provides an excellent insight into the auditor's problems and the audit approach of his firm, Touche Ross & Co., in coping with the detection of management fraud.

The next two papers presented at the proceedings involve the auditor's report. Lee J. Seidler's paper, "Symbolism and Communication in the Auditor's Report," discusses the auditor's report as a symbol; how symbols are used in communication; and some of the communication problems with the auditor's report as a symbol carrying a complex message to the user. D. R. Carmichael's paper questions the need for, and usefulness of, the "subject to" qualification in the auditor's report.

In "Status Report on Auditing in the European Economic Community," Richard L. Kramer gives a comparison of accounting and auditing practices in the European Economic Community and in the U.S. Boyd Randall and Paul Frishkoff in "An Examination of the Status of Probability Sampling in the Courts" examined past court decisions in which probability sampling was used in order to gain insight into whether the use of statistical sampling in auditing would be a better defense in the courts than judgment sampling.

"Use of Decision Theory in Auditing—A Practitioner's View," by James K. Loebbecke, probably best brings the practicing auditor's world and the academic world together by discussing and attempting to demonstrate how decision theory might be used by auditors in controlling audit risk.

Finally, "Capital Investment and U.S. Accounting and Tax Policies," the evening address by Richard D. Fitzgerald warns of the future undercapitalization of American businesses. Fitzgerald points out some of the U.S. income tax policies that hinder capital formation and how the burden of additional disclosure requirements sometimes can dampen capital formation.

Symposium III should be of interest to auditors interested in contemporary auditing problems. Auditing historians will probably find the historical development of internal control paper a quick overview and, if coupled with the other Symposia historical development papers, an interesting and quick review of the literature.

Howard F. Stettler, Editor, *Contemporary Auditing Problems: Proceedings of the 1974 Arthur Andersen/University of Kansas Symposium on Auditing Problems* (Lawrence, Kansas: School of Business, University of Kansas, 1974, pp. 121, paper, $5.00).

Reviewed by
William Yellin
St. Francis College

This book contains fifteen papers covering the concerns and often differing viewpoints of the Symposium participants regarding the following topics: Auditor Independence: Its Historical Development and Some Proposals for Research; The New AICPA Audit Commission—Will the Real Questions Please Stand UP?; Controlling Audit Quality: A Responsibility of the Profession?; Relationship of Auditing Standards to Detection of Fraud; A Decision Theory View of Auditing; Setting Standards for Statistical Sampling in Auditing; The Sample of One: Indispensable or Indefensible?; The Case for Continuation of Mandatory Independent Audits for Publicly Held Companies. The participants represented a cross section of the profession, namely academia, public accounting, and governmental agencies. Each topic was covered by two papers of differing viewpoints except for the last topic listed above which was covered by one individual. First, a brief topical history mixed with the personal viewpoints of the writer was presented. Then the second discussion paper was presented addressing itself to the personal viewpoints of the author of the preceding paper.

In many cases, the viewpoints reflected the occupational backgrounds of the writers. For instance, the initial paper on independence was presented by an academic who suggested at one point that a strengthening of auditor independence might be furthered by paying the auditor from public funds. The second paper, presented in direct response to this paper, opposed this view as an impractical solution because of the wide disparity of the accounting and auditing services being rendered. This response was written by a member of the public accounting profession that one might expect to espouse this premise.

The symposium was organized by having all papers distributed in advance to all participants so that preparers only made brief comments on their paper. Time was then allotted to the writer of the discussion to reply, followed by an open discussion by all the remaining participants. The papers were all thoroughly prepared and citations to previous applicable literature were made for historical

background. However, I think that accounting personnel representing the private companies which are the subject firms of an audit should have been represented, in order to supplement the academic, public accounting, and governmental viewpoints.

I believe that readers of this publication would have also been interested in reading some of the points made by the participants when the topics were opened to general discussion. I suggest inclusion of selected general discussions in future publications of this symposium.

The presentations contemporary to 1974 are still contemporary today. There were suggestions for quality control programs within the public accounting profession as well as continuing education programs. These are still current topics and the profession has moved forward with peer review programs within the American Institute of CPAs and mandatory continuing education programs in various states. The public accounting profession itself is continually answering many of the questions raised in this 1974 symposium. This publication will provide researchers and members of the profession an excellent source document summarizing the questions facing auditors today.

Arthur L. Stinchcombe, *Theoretical Methods in Social History,* (New York: Academic Press, 1978, pp. X, 130, $10.00).

Reviewed by
Linda B. Ferreri
Case Western Reserve University

Arthur Stinchcombe's expressed purpose for writing this book was to demonstrate that "one uses history to develop theory" and to outline a general methodology to be used in achieving this. He casts doubts on the logical positivist ideas of research and uses the works of Trotsky and deTocqueville to show that the difference between them "makes hardly any difference to any important question of sociological theory."

The methodology he suggests is in the nature of a logical analogy. To simplify tremendously, analogies of historical instances are selected. Then a three step process is used to reduce the analogy "to its scientifically relevant predicates" in order to develop "causually interesting sentences." The three comparisons are an ideal sequence comparison, a comparative history of roles and a comparison of functional equivalents. Stinchcombe uses these steps to

analyze Neil Smelser's *Social Change in the Industrial Revolution* and Reinhard Bendix's *Work and Authority in Industry*.

There appear to be several problems with the methodology and the perspective advanced by Stinchcombe. One such problem is apparent in his analysis of the works of Trotsky and deTocqueville. He finds a number of important parallels between the analyses of the two men. Trotsky, in describing the Russian Revolution, and deTocqueville, in describing the French Revolution, each cites such factors as ineffective authority, increasing injustices, dual powers, and the use of symbols as factors that were present prior to the revolution. Stinchcombe sees these as analogies that can be used to infer "the nature of the causal process." His methodology, however, has no means of weighting the importance of these factors. No two historical incidents can be found to have exactly the same preconditions in exactly the same strength. Similarly, conditions that may have little or no importance in one situation may be of overriding importance in another. For example, religious differences played an essential role in the Irish Rebellion but almost no part in the American Revolution. The use of this system of parallels would apparently accord no importance to religious conflicts since they are not present in both situations.

Another problem with this methodology is that Stinchcombe's analysis is limited to disruptive periods. His discussion of Smelser's arguments about social change among workers in the Industrial Revolution is extremely compelling and interesting. His comparison of the roles of male workers before and after industrialization, for instance, is enlightening although he places more emphasis on social factors than may be justified. However, it appears doubtful that such a comparative process would be equally profitable in periods in which more subtle changes were taking place.

This book has some interesting points to make about theoretical methods in social history and is very thought-provoking. It might best be read by those who are familiar with the four works specifically analyzed by the author although he does quote them frequently enough to invoke the flavor of their arguments.

The methodology may have shortcomings and it certainly does not appear to be as generalizable as Stinchcombe implies but it is a fresh possible approach within its limitations.

Norman E. Webster, Compiler, *The American Association of Public Accountants: Its First Twenty Years, 1886-1906.* (New York: American Institute of Certified Public Accountants, 1954. Reprint edition: New York: Arno Press, 1978, pp. xi, 402, $31.00).

Reviewed by
Paul Frishkoff
University of Oregon

Modesty is a characteristic which is perhaps no longer much valued in our society. This may be because some modest people have, as Mr. Churchill said of Mr. Attlee, "ample reason for so being." Such is *not* the case with Webster, who is self-effacingly listed as "compiler" of this book—a history of an AICPA predecessor—though he appears to have been researcher (in the best sense of the word) and author.

The unexpected dearth of existing records of this association was no deterrent to the author, then chairman of the AICPA Committee on History (and a right venerable age himself, according to the Library of Congress cataloging information on the inside cover page.) He painstakingly reconstructed events, memberships, philosophies, out of the paucity of records but primarily from a most thorough reading of numerous business and professional journals and periodicals of the era. Many doctoral dissertations involve less work than this.

What emerges is a picture of the formation, contributions, and eventual merger of this rather Victorian society of gentlemen. (Indeed, as Webster briefly points out as an afterthought, women were denied admission, although a few very eligible female accountants were in practice during this period. He fails to point out as directly that the membership was almost entirely Anglo-Saxon in makeup, about half the members having been born in Britain or its Commonwealth; whether membership was denied to more ethnic types, or if any applied, Webster doesn't really say.) Biographies of each member, even those who resigned after a short while, are reconstructed by the author. The impression that one gets is that surely this was the "creme de la creme" of New York accountants.

The orotund tones and circumspect language which characterized some of the speeches and correspondence of members of the society and of Society as well, are echoed in the author's writing. For instance, though he documents at length the denial of admission to various individuals for unethical conduct, he substitutes blanks for the actual names, leaving future researchers just a bit

more (unnecessary) digging to do. The ethical breaches, we might vote, involved not only fraud but *false* advertising, since advertising itself was very much accepted by the profession at the time, as it is once again slowly becoming today.

Another point, which one can cull from the biographies, is the relative lack of a college education by the members. This is a point which is, of course, familiar to those who have read Edwards' or Previts and Merino's books, among others. Yet in no sense were these people unlettered; judging from the portions of speeches and letters which Webster reproduces, their command of the language dwarfed that of most contemporary students (and of many contemporary academics).Their sophistication in *accounting* appears less impressive, since bookkeeping and rather mundane auditing seem to have occupied the bulk of their practices. (This was, we should recall, the fabled era prior to the Federal Income Tax.)

The contributions of the Association to the first CPA licensing law, and the ramifications thereof, including the attempt to "grandfather" practicing public accountants out of the examination requirements, make worthwhile reading.

To those with a keen interest in the history of American accounting, public and private, this book may be a worthwhile acquisition. It certainly belongs in better university library collections. Of course, it is not flawless. The book lacks a bibliography and footnotes, although the source of almost all of Webster's assertions is documented in a scholarly manner. Although it appears tightly organized, there are many extremely short chapters, which is mildly disconcerting. And Webster's style assumes that any reader has digested the whole book word-for-word, so that skimming is extremely difficult and none too fruitful. Perhaps most annoying, the book lacks an index, a flaw which could be remedied by a zealous professor or student with time on his or her hands.

M. C. Wells, Editor, *American Engineers' Contributions to Cost Accounting* (New York: Arno Press, 1978, irregular pagination, $31.00).

Reviewed by
Robert R. Locke
University of Hawaii at Manoa

In this collection of pre-1914 articles, nineteen reprints taken primarily from the *Engineering Magazine* and the *Transactions of the ASME,* the editor, M. C. Wells, seeks to show how American elec-

trical and mechanical engineers "gave the development of costing methods and cost accounting the impetus which has brought it to its present position of prominence." (p. 4) Accordingly, the articles are grouped to reveal the interest that engineers had (1) in the financial aspect of efficiency (articles by F. P. Goddard, H. R. Towne, R. H. Thurston, C. E. Emery and E. R. Spedden), (2) in the problem of pricing (articles by G. F. Fowler, H. M. Lane, A. W. Farnsworth and R. S. Hale), (3) in the development of cost records for internal shop management purposes, as opposed to more formal cost accounting procedures per se (articles by H. Metcalfe, H. M. Morris and H. Roland), and (4) in the elaboration of costing principles (articles by H. Roland, J. G. Newton, P. Longmuir, P. J. Darlington, A. H. Church and H. R. Towne).

Although the contribution of the engineers to cost accounting is undeniable (and hence the publication of these reprints most welcome), significantly some of the articles reproduced are not by engineers. That by Dr. E. R. Spedden, "Is the Study of Economics Useful for Engineers," is a case in point, for, if its publication in an engineering periodical indicates a growing awareness of economic science in engineering circles, its contents and authorship show how deficient the engineers were in this respect. Indeed, this collection of essays demonstrates the extent to which engineers remained ignorant of economic principles (opportunity costs, marginal analysis, etc.) that would have helped them solve many costing problems.

It is easy, of course, to make this criticism from our perspective. But contemporaries were aware of the engineers' failure to incorporate economic principles into their work on cost accounting. The great German business economist, Eugen Schmalenbach, repeatedly pointed this out in his reviews of books by engineers on cost accounting. He stressed, for example, the importance of marginal analysis in pricing, something, which these essays prove, American engineers did not take into consideration in their cost accounting.

Wells' assessment of the American engineers' contribution to cost accounting would have been improved, had the editor, in his introduction, examined their work more critically within the context of contemporary comment.

M. C. Wells, Editor, *Controversies on the Theory of the Firm, Overhead Allocation, and Transfer Pricing* (New York: Arno Press, 1980, irregular pagination, $20.00).

Reviewed by
Eric Brucker
University of Delaware

This collection of eighteen articles, including ten written by Wells, addresses three controversies in managerial accounting: the allocation of overhead costs, the establishment of internal transfer prices, and the amortization of deferred charges. Wells analyzes the various viewpoints within the context of a profit maximizing theory of the firm and the associated marginal conditions. Overall the author clearly succeeds in meeting his self-imposed goal of stimulating the reader to "think a little more about what accounting is, and what it could or should be."

The stage is set by reviewing the competing theories of the firm. Machlup's 1967 classic, "Theories of the Firm: Marginalist, Behavioral, Managerial," provides an excellent overview. Machlup primarily defends marginalism on grounds of its superior predictive power rather than on the realism of the profit maximizing assumption. However, in two empirical articles examining managers' motivations, Wells suggests that the assumption may be realistic. While Wells presents interesting data, Machlup's justification remains the more convincing.

With the case for marginalism stated, Wells presents well reasoned arguments against the allocation of overhead costs of products or operating divisions within an organization. Similarly, the practice of establishing transfer prices is convincingly questioned. In his view, attempts to alter divisional managerial behavior by distributing cost and impacting divisional profits will succeed in changing behavior. However, the change will almost certainly cause the firm to move away from a profit maximizing allocation. Overhead allocation formulas and arbitrary transfer prices based upon historical accounting data rather than current market prices do not motivate managers to behave in accordance with marginal principles. "The evaluation of the performance of managers should be based on those matters over which they have control."

If the existing methods of cost allocation are not consistent with the marginalist view of the firm, what does Wells propose? An activity accounting model is set forth based upon Chambers' system of Continuously Contemporary Accounting. The use of activity,

rather than product costing, makes the accounting data more suitable for managerial evaluation against a given and agreed upon budget. By using current cash equivalent for all assets Wells claims that the information provided by the system is "unaffected by overhead allocations, fictitious revenues and transfer prices, depreciation provisions, and other fabricated figures." His suggested system is thought-provoking but, in the opinion of the reviewer, creates new needs to fabricate new kinds of data. For example, it is especially difficult to envision a system which could accurately capture the current market value of assets without incurring exceptionally high costs or adopting rules of thumb.

Overall this collection of articles is well worth reading. It gives an overview of how the underlying theory of the firm clearly relates to the appropriateness of certain conventional accounting practices. This volume forces the reader who does not agree with Wells' condemnation of traditional internal costing models to consider whether the disagreement reflects a fundamentally different underlying theory of the firm or whether, and where, errors in his analysis have been made.

John R. Wildman and Weldon Powell, *Capital Stock Without Par Value* (Chicago: A. W. Shaw Company, 1928. Reprint edition, New York: Arno Press, 1980, pp. ix, 553, $48.00).

Reviewed by
John A. Yeakel
University of New Mexico

Readers of this important book will quickly discover that the authors were writing from a much broader perspective than is implied by the title. There are extended discussions of the nature and meaning of profit and its relation to surplus. Issues that are not vital to the discussion of no-par stock are included; the chapters on voting and non-voting shares and on treasury stock are cases in point. The work is, in large measure, a treatise on accounting theory for enterprise capital. "To whom does the surplus belong?" is a recurring theme of the authors. The book is also a strong statement for full disclosure on corporate balance sheets.

The text consists of twenty-two chapters of discussion and analysis that comprise the first 288 pages, plus another 243 pages of verbatim excerpts from the statutes of the forty states which, by 1927, permitted no-par stock. The discussion and analysis is ex-

haustive. It includes such topics as no-par preferred, cash and stock dividends in relation to no-par shares, reorganization, mergers, consolidations, and taxation questions, with repeated emphasis upon the advantages of shares without par value over both par and stated value shares. Although attention is given to potential problems, the authors seem to have viewed no-par shares as a virtual panacea for a wide variety of corporate ailments. The advantages and disadvantages of shares without par value are clearly and concisely listed on pages 43 and 44.

The book is replete with examples—in many cases corporations are named—so that there is no misunderstanding about the concepts being discussed. Legal statutes and cases are used frequently to illustrate the analyses. The writing is very clear and understandable. But, because of the authors' stated desire to make the discussion in each chapter complete in itself, there is a considerable amount of repetition throughout the book. Perhaps, readers will not enjoy reading the entire book at one sitting.

Accounting historians will particularly appreciate the chapter on the historical developments leading to the use of no-par shares in the United States. I have long held that accounting students deserve better explanations of the meaning of, and the reasons for, par and no-par stock than are commonly found in, for example, intermediate textbooks. Textbook authors could significantly improve their chapters on stockholders' equity if they took the time and trouble to study the first three chapters (45 pages) of *Capital Stock Without Par Value.*

Stephen A. Zeff, Joel Demski, and Nicholas Dopuch, Editors, *Essays in Honor of William A. Paton: Pioneer Accounting Theorist* (Ann Arbor, Michigan: Division of Research, Graduate School of Business Administration, University of Michigan, 1979, pp. xiii, 217, $12.50).

Reviewed by
Janet Kimbrell
Oklahoma State University

For the individual prepared to read a collection of essays concerned with Paton's viewpoint of accounting theory, this book may be a disappointment. The exception to this is Stephen Zeff's historical account of Paton's writings from 1916 to 1955 on the effects of changing prices. The reader interested in following the evolution

of Paton's thoughts on accounting for changing prices will find this article to be worthwhile reading.

Another worthwhile contribution of the book is the extensive bibliography of Paton's works. The comprehensive listing contains most books, articles, and book reviews written by Paton. It also includes submissions to the federal government.

The remainder of the book is an eclectic assortment of essays on accounting topics. The purpose of Carl T. Devine's essay on "Observations on Internal Control" is to suggest that investigations of internal control fail to consider the deterrent effect of the arrangements made to prevent violations, particularly collusion. Without the knowledge of this deterrent effect, it is difficult to make assessments of internal control.

David Solomons discusses the dangers of the politicization of accounting, in that it is not the function of the Financial Accounting Standards Board to influence preselected economic behavior to achieve national goals, or promote some mode of behavior. His view is that the function of accounting is purely for measurement purposes and that neutrality should be a major goal in setting accounting rules.

Harold Bierman argues the feasibility and desirability of setting standards. A general set of operating guidelines should be defined before the accounting profession attempts to define specific problems. This general framework can be used to analyze those specific problems. In addition, Bierman contends that difficulty encountered in the measurement of accounting values should not stop the profession from attempting to make that measurement.

In "Accounting for Investments in Debt Securities," Maurice Moonitz first compares debt and equity securities and then analyzes the behavior of an investment in debt as the market rate of interest changes. The major argument presented in this essay is that realized profits should not be combined with unrealized profits in the calculation of net income, as this practice may lead to misuse and confusion.

R. J. Chambers defines "The Hard Core of Accounting" as money and money's worth (money equivalent of assets). It is Chambers' contention that a balance sheet representing assets and equities in terms of their money equivalents will best answer the accountant's asset measurement problem. This is yet another argument for CoCoA (continuously contemporary accounting) and adds little to a previous paper on the topic written by Chambers.

In "Relationships Among Income Measurements," Norton Bedford examines five income measurement models: historical cost, price-

level adjusted historical cost, current exit value, current replacement cost, and present value of expected cash flows. Using the concepts of psychic, real and money income as a framework, Bedford attempts to analyze the relations among the five income measurements.

Gordon Shillinglaw develops a conceptual framework to be applied in the field of product costing. His suggestion for a framework includes basic concepts of costing, constraints of the system, criteria for system choices, and measurement principles. The discussion includes the problems encountered in applying these principles, as well as a rationale for including them as principles. This particular essay would be a useful guide to the beginning cost accounting student in that it discusses these problems and, in addition, some basic relationships in cost accounting.

The last essay in the book is "Social Performance Accounting" by R. Lee Brummet. After giving credit to a limited number of accountants who have been concerned with the social responsibilities of the accounting profession, he then charges that the profession, in general, has been reluctant to assume its role in the measurement of social performance. It is his belief that accountants have a responsibility not only to report upon the financial measurement of an organization, but also to report upon the measurement of social welfare efforts and impacts.

For the accounting historian, this book probably contains only one item of interest—Stephen Zeff's essay on Paton and the effects of price changes. The other eight essays, while interesting, add little to the history of accounting thought. However, this does not imply that these would not be of value to a reader interested in accounting theory.

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DOCTORAL RESEARCH

Maureen H. Berry, Editor
UNIVERSITY OF ILLINOIS

The emphasis in the current selection of recent doctoral dissertations is on the birth of certain types of trade and the effects of the environment on the way in which these industries developed.

Our first contrast focused on the differences between fur trading in Russia and Canada. In medieval Russia, competition was fierce between political forces in different geographical areas. In Canada, on the other hand, two competitors wrestled for control over common grounds. We move on a little later in time to investigate the growth of the Brazilian economy. Sweigart's dissertation is an in-depth study of a particular industry, coffee export. Reiss, on the other hand, has a more general concern: the characteristics of national industry development when industrial growth comes late in a nation's life. We close with a look at the introduction of industry into North America. Here, we find the national character of the proud egalitarian to be a driving force in the birth of the American labor movement.

Treasure of the Land of Darkness: A Study of the Fur Trade and its Significance for Medieval Russia (X-XVI Centuries) (The University of Chicago, 1980; 41/07, p. 3214-A)[1] by Janet L. B. Martin. During the medieval period, the northern fur trade was an important element in the political and economic development of the Russian and mid-Volga principalities. Little has hitherto been known about its operations however. Starting with the first available records from the tenth century, this dissertation traces the growth of the system and the patterns of trade over a 600 year period, until Muscovy monopolized political power and incorporated the major suppliers and fur centers into its boundaries.

The variety of sources tapped for this research is impressive, including Islamic, geographical and historical tracts, numismatic and archeological data, Russian publications and archival documents,

[1]*Dissertation Abstracts International,* volume and page references.

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ethnological studies, Scandinavian sagas, Western European travel accounts, and commercial documents.

The fur network ranged over a very wide land area. From the river valley of the North Dvina, Pechora, and Ob in the northern regions, the traders brought down the pelts to the major collection and distribution centers which included Novgorod, Moscow and Kazan. From there the sables, ermines, martens, and foxes as well as the less luxurious beavers and squirrels were moved on to waiting markets in Central Asia and Constantinople, the gateways to Iran and Europe.

Silver was the usual commodity received in exchange. Control by the trade centers over major elements in the supply system, such as the initial sources and key locations along the trade routes, shifted as the trade expanded.

The dissertation's estimates of the volume and profitability of the fur trade from exporting centers in Novgorod and Moscow support the thesis that there was a connection between the volume of trade and political struggles in those areas.

The North American Fur Trade 1804-1821: A Study in the Life-Cycle of a Duopoly (The University of Western Ontario (Canada), 1980; 41/12, pp. 5193-4A) by Ann Martina Carlos. In North America, two companies controlled the fur trade during the period 1804-1821: the Hudson's Bay Company (HBC), named after its base of operations, and the North West Company (NWC) which operated out of Montreal. The main objective of this study was to analyze the inter-firm behavior of this duopoly during its 16 year life cycle.

The initial years were marked by passive competition which could be characterized as a Cournot behavior model. This ended, however, with the Napoleonic Wars when the HBC suffered severe financial crisis and adopted an aggressive operating style. Despite this challenge, the NWC was content to play the role of follower, a situation which Carlos equated with the Stackleberg leader-follower model. However, NWC also began to experience financial problems as the depletion of the fur-bearing animal population continued. It then imitated the behavior of its adversary. An end to this competition came with the merger of the two companies, after three previously unsuccessful attempts, in 1821. The dissertation analyzes these previous failures, the reasons for the success of the fourth attempt, and the economic bases for the observed duopoly behavior.

Financing and Marketing Brazilian Export Agriculture: The Coffee Factors of Rio de Janeiro, 1850-1888 (The University of Texas at Austin, 1980, 362 pp; 41/11, p. 4809-A) by Joseph Earl Sweigart. This dissertation identifies and describes the key role played by the factor, who was the planter's commission agent, in Brazil's export coffee trade during the second half of the nineteenth century. The research relied mainly on archival search of such sources as partnership and mortgage contracts and registers, as well as financial statements attached to commercial litigation documents, and inventories of estates. Secondary sources included official regulations, company prospectuses and bank reports, official journals, newspapers, and directories.

This trade centered in the port of Rio de Janeiro and was the mainstay of the country's economy. The factor had three main functions: he acted as an intermediary between plantation owners and coffee buyers; he purchased supplies for the plantation which were worked by black slave laborers; and he obtained the credit needed to finance coffee production.

All phases of the coffee trade were controlled by native Brazilians or Portuguese family members. As a result, kinship ties strengthened the partnership arrangements typical of many business relationships between planters and factors. The entrepreneurial activities of the factors were diffused throughout the agricultural, industrial, and financial sectors of the economy. For example, they expanded commercial banking in Rio de Janeiro to finance the production and marketing of coffee; they tried to develop an agriculture capital market; they invested in a number of enterprises, including textiles; and they directed transportation and insurance companies.

By the 1880s however, reversals set in. The economic effects of a severe decline in coffee prices were exacerbated by the abolition of slavery in 1888. However, although some factors were forced out of business, most of them retained their dominant position in the country's business community.

Development of Brazilian Industrial Enterprise: A Historical Perspective (University of California, Berkeley, 1980, 422 pp; 41/07, p. 3210-A) by Gerald Dinu Reiss. The major hypothesis tested in this study is that the growth pattern of industrial firms exhibits certain national characteristics. The latter include forms of production, products, finance, management and markets as well as certain interfirm and client/firm relationships. The dissertation tests this proposition through a historical analysis, focusing on the growth process

of individual firms. There were three major phases of industrial development in Brazil. The earliest stage occurred when the nation was primarily a coffee export economy and little industrial investment took place. This instability in industrial growth continued until 1929. During the next two decades industry grew rapidly in an environment marked by restrictions in the finance of imports. During the latest stage starting in the 1950s, the economy developed a markedly international character. The related intensification of competition in certain markets forced firms to make dramatic adjustments to the new conditions and competitive relationships with foreign subsidiaries.

The distinctive historical features of late industrial development and their lasting consequences for Brazilian national firms are illustrated by six specific case studies.

The Beginnings of the Industrial Revolution in America: Pawtucket, Rhode Island, 1672-1829 (Brown University, 1980, 404 pp; 41/12, p. 5221-A) by Gary B. Kulik. America's first experiences of the factory system occurred when Samuel Slater introduced Arkwright's spinning machinery into Pawtucket, Rhode Island in 1790.

This village had already been well established for over a century supporting itself through artisan production and agriculture. The new mill owners seeking to impose their own cultural influences and political power had, therefore, to confront a set of existing traditions. One of the strongest challenges to the new system was a deep sense of egalitarianism among the native population. This found expression, collectively, in 1824 when the American textile workers struck for the first time. Opposition also came from the household farmers whose arable land was flooded by the unrestricted damming of rivers. The basic alterations wrought in the landscape and in the general ecology by the new technology also had parallel effects on the social infrastructure. Resistance by the farmers, the artisans, and the mill workers was the force which limited the power of the mill owners to set their own new definitions of work and leisure.

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